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ROYAL COMMISSION ON TAXATION

Proceeding of hearings held before the Royal Commission on Taxation, in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9.30 a.m., on Wednesday January 15, 1964.

COMMISSION:

Mr. Kenneth LeM. Carter -- Chairman

Mr. Harvey Perry

Mr. Donald M. Grant

Mrs. S.M. Milne

Mr. Charles E.S. Walls

LEGAL ADVISER:

Mr. J.L. Stewart, Q.C.

RESEARCH DIRECTOR:

Prof. F.D.G. Hartle

SECRETARY:

Mr. G.L. Bennett

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SUBMISSION OF

THE CANADIAN WHOLESALE COUNCIL

APPEARANCES: R. H. Bainard, Chairman.
- President, National Grocers Co. Ltd.
- Vice-President, Red & White Corporation of Canada Limited.

A. Boisvert
- Executive Vice-President, Canadian Grocery Distributors' Institute.

A. J. Duhamel
- Managing Director, National Association of Tobacco & Confectionery Distributors.

H. W. Jones
- General Manager, Drug Trading Co. Ltd.

H. Macdonald
- President, H. Macdonald Limited, and G. B. Company, Oshawa.

T. H. Whellams
- Executive Vice-President, Canadian Automotive Wholesalers & Manufacturers Association.

H. W. Near
- Secretary, Canadian Wholesale Council

THE CHAIRMAN: Mr. Secretary, are we all assembled?

THE SECRETARY: We are all ready, Mr. Chairman.

THE CHAIRMAN: Then we might start.

THE SECRETARY: Mr. Chairman and Commissioners, the first brief this morning is being presented by the Canadian Wholesale Council. Mr. R. H. Bainard is Chairman of the Council. Mr. Bainard is President of National Grocers Co. Ltd. He has with him a number of associates of the Council. Mr. Bainard will speak to the brief and will introduce his colleagues. I would like to enter this brief into the record, Mr. Chairman, as Exhibit No. 312.

-- EXHIBIT NO. 312: Brief of the Canadian Wholesale Council

THE CHAIRMAN: Thank you, Mr. Secretary.

Good morning, Mr. Bainard and gentlemen. We are glad to see you indeed. We have, of course, read your submission, I might say with considerable interest, and we will have a number of questions to put to you. There is no need to re-read it; that has been done. But if you would care to say a few words in respect of the brief and your organization, and particularly to introduce your colleagues, I would appreciate it.

MR. BAINARD: Thank you, Mr. Chairman. I would like, first of all, to introduce the members of the Council who are here. I think it has not any connection with the fact that the ancient Hebrew perfect number was seven, but it so happens that we are seven.

When introducing these gentlemen I will

indicate the scope which they cover. We state in our brief that we are the Canadian Wholesale Council and in our introduction we have told who we are and why we exist. We cover Canada from coast to coast and we cover all phases of the trade.

On my far left is Mr. Whellams, the first man I introduce, who is the Executive Vice-President of the Canadian Automotive Wholesalers & Manufacturers Association. That is a Canadian association that goes from coast to coast. Next is Mr. Harry Jones, who is the General Manager of the Drug Trading Company Ltd., which is a limited corporation, a wholesale company that is owned by 1,800 retail merchants. It is incorporated, you will note there. To my immediate left is Mr. Boisvert, who is the Executive Vice-President of the Canadian Grocery Distributors' Institute, which covers the wholesale food business from coast to coast. It is a Canadian organization. On my immediate right is Mr. Near, who is listed in our brief as Secretary of the Canadian Wholesale Council. He is acting in that capacity in the absence of Mr. Joseph Crowder, who is on holiday in Florida. Mr. Near is the Secretary-Manager of the Plumbing and Heating Wholesalers Association, and Secretary-Manager of the Canadian Hardware Association. Again, this is a national association. Next to Mr. Near is Mr. Hagen Macdonald who is Past President of the National Association of Tobacco and Confectionery Distributors. He is the President of Hagen Macdonald Limited of Oshawa.

He is also President of G. B. Company Limited of Oshawa, which distributes on a national scale what is usually known as small wares. Again, that is national. To the far right is the Managing Director of the National Association of Tobacco and Confectionery Distributors, Mr. A. J. Duhamel. I am President of the National Grocers Company Limited, a wholesale food organization that operates in the province of Ontario and, to some extent, in Quebec, with 32 wholesale branches in our organization. I am also Vice-President of the Red & White Corporation, which is a national franchise, a voluntary chain franchise. We extend from Newfoundland in the east to Vancouver Island in the west.

Our purpose can be very briefly stated, I think, and that is to emphasize the importance of the wholesale distributor in all phases of the distribution cycle. There are many ways, as we have said, in which the merchandise purchased for one purpose or another reaches the ultimate consumer, but the main sources are the wholesaler-retailer team which distributes merchandise, and the manufacturer who sells direct to the chain store or the department store. Both functions are performed by both groups. On the one side, the team of wholesalers and retailers is working together to distribute products, imports, which are processed, and so on, and on the other hand you have those products reaching the retailer direct.

Those two sources must be competitive.

We represent one source and, as we have said in our brief, it is a very important one. That is something we would like to emphasize. The other point we would like to emphasize is the fact that we are truly national; we go from coast to coast -- not just the province of Ontario or the province of Quebec, but we go from Newfoundland in the east to Vancouver Island in the west.

I understand that the purpose of this hour which you were kind enough to grant us was that you might ask questions of our various members. I have described them. If the Members of the Commission wish to direct their questions to the various members here, well and good; or if they will direct them to me, I will try and get them answered by the people who are best qualified to answer them.

I will have a little more to say toward the end by way of summarization.

THE CHAIRMAN: Thank you, Mr. Bainard, indeed. I think we will address our questions to you, and you can field them to whomever you please. You tell us that there are 26,000 wholesalers in Canada, or thereabouts, and it is very easy to understand what a soft goods wholesaler looks like, what a dry goods wholesaler looks like, or a grocery wholesaler; but for the life of me, I cannot see how there can be as many as 26,000 of those.

I suppose I am not thinking of all the little wholesalers who are doing specialized work.

Can you in any way make the industry a little clearer to us as to what the 26,000 is made up of?

MR. BAINARD: I think Mr. Boisvert has in his brief, as a matter of fact, some figures on this and I will ask him to answer that question. We, of course, have listed on page 3 the D.B.S. listing of classifications.

THE CHAIRMAN: Indeed you have.

MR. BOISVERT: The 26,000 wholesalers were drawn out of the statistics for 1951, and it was not possible to get the exact picture for 1961, except that the figures that are known resemble closely enough those in 1951; there have not been drastic changes in the picture.

MR. BAINARD: The 1961 census figures were not available in the detail we would like to have.

THE CHAIRMAN: Are they to be available?

MR. BAINARD: They are to be available. We were in touch with the D.B.S., as a matter of fact, but unfortunately they are just not available.

COMMISSIONER WALLS: Most of their reports are out, but yours is one of the last of them, I believe.

MR. BAINARD: I think that is true.

MR. BOISVERT: I have not the exact breakdown of the figures.

THE CHAIRMAN: Have you anything there?

MR. BOISVERT: I would have to dig for them. If you will go on to another question

I will see what figures I have.

THE CHAIRMAN: You say that most business is conducted by the wholesaler-retailer team. Looking at the figures you have given here, as I added them up I thought that about 50 per cent probably was.

MR. BAINARD: Of course, it would be an estimate as to whether it is 50, 60 or 65 per cent.

THE CHAIRMAN: It is in that order.

MR. BAINARD: Yes. It has to be an estimate because, again, no exact figure is available. I would hope that when the figures of the 1961 census are available we would have available the amount of sales which have actually gone through wholesale channels.

THE CHAIRMAN: The general impression abroad seems to be that the wholesale trade is declining. Do you agree with that view, or not?

MR. BAINARD: No, I would not say that the wholesale trade is declining. I would say that the wholesale trade has been strengthened in this way: It is more competitive; it is more efficient. As I said a moment ago, the wholesaler-retailer team must be competitive with the merchandise that is sold direct to department stores, chain stores, or what have you. The two systems must be competitive or one or the other will fail.

The point we are trying to make is that in the national picture the wholesaler-retailer team

is indispensable and therefore nothing should be done to weaken one side of that competitive situation when compared with the other, as we think would be the case if the suggestion were to be made to go to the wholesale level for the computation of sales tax.

THE CHAIRMAN: When I said "declining", I meant relatively declining. It has been represented to us that a decreasing proportion of the nation's goods are passing through wholesalers.

MR. BAINARD: A decreasing proportion?

THE CHAIRMAN: Yes, a decreasing proportion.

MR. BAINARD: It depends how far back you go. If you go far back, that is true. If you compare last year against this year, or the year before, I would not agree.

THE CHAIRMAN: Ten years?

MR. BAINARD: You would be correct in regard to food. The D.B.S. statistics show that an increasing proportion of the total sales goes through the chain organization, whereas you will notice that on the national level there is a greater proportion goes through independent channels than goes through the chain.

COMMISSIONER WALLS: That is because the voluntary chains have created a renewed impetus in food wholesales?

MR. BAINARD: Yes. That is going back a long way. I happened to be President of the

original firm when some 30 odd wholesalers were given an option on their businesses and a new company was being formed and operated. Except for the efficiency and introduction of voluntary chains, with the advertising promotion and all the rest of it, that segment of the indudstry would be in trouble.

COMMISSIONER WALLS: But I think what has kept your figure up with wholesale houses is the developments with regard to unlicensed wholesalers, who are indeed just a sub-department of the manufacturer. In other words, I think you realized that in regard to footwear, clothing, and things of that kind, the manufacturer is dealing much more today directly with the retailer than he did a number of years ago.

MR. BAINARD: That is true.

COMMISSIONER WALLS: But where the manufacturer is operating an unlicensed wholesale, that would be added to your total wholesalers, and I think that is what keeps up your figures.

MR. BAINARD: I could not say to what extent that would be true, of course.

THE CHAIRMAN: That would be true on the licensed figures, but would it be true on the D.B.S. figures?

MR. BAINARD: I would not think so.

COMMISSIONER GRANT: Are the independent merchants which form part of a chain, such as the Red and White stores, listed with regard to their sales as a chain, or are they listed as

independents?

MR. BAINARD: They are listed as independents. They are independently owned, you see. The same is true of I.G.A. and other organizations like that. They are independently owned.

COMMISSIONER GRANT: I have a figure at the back of my mind that 80 per cent of the food purchased today is through the supermarket. That is, the purchases of food, groceries and meat.

MR. BOISVERT: I would go along with you by stating that 80 per cent of all food sales is done through either chain or voluntary chain stores, organized distribution along the lines of the wholesaler-retailer team function.

To reply to Mr. Carter's first question, the general direction of the wholesale industry, starting from the food industry and then going into a trend that has the tendency to contaminate the other wholesale areas, I have this to say. In contrast to what the situation was say ten or twelve years ago, when the wholesalers handed over to the retail trade merchandise which they invoiced at the price for their retailer to do with as he pleased and on his discretion in competition, there is better organized opposition. Today the fully developed voluntary group operation, apart from supplying groceries also supplies, in the end product, as many as 33 other categories of merchandise and as many as 55 different types of

services, which makes him not only fully competitive with his corporate chain opposition, but he is gaining on it where that has been the pattern.

This type of co-operation which has had as a goal -- to take an easy comparison -- to supply the isolated individual, the independent whose only weakness was his isolation because he is then the holder of, say, three or four resources or talents with which to conduct his business, his wholesale supply house now brings him in the missing 20 or 21 tools, and then he is in business and collectively, although he may be smaller individually, he is awfully big business.

He has a future. This has taken hold in the smaller bakery industry, in the province in which I live at least, where they are developing a common brand with which to advertise and stay in business, rather than being bull-dozed away by the bigger concerns which have 25 tools to fight his three or four.

This has gone into the furniture business. The Prestige group in the province of Quebec is an example thereof. The druggists have been in this scheme of things for some time, and this is going, in the next five or six years, to carry over into a great many other fields, the co-operative effort.

MR. BAINARD: Mr. Grant, as to the 80 per cent, the available figures here for 1962 of the D.B.S. show that grocery and combination sales

amounted to $3,700,000, of which $1,700,000 was from chain and $2 billion through independents. Some of those independents would be supermarkets. It depends what you call supermarkets, Mr. Grant, when you use the 80 per cent figure, or a 70 per cent figure, or a 60 per cent figure. What do you mean by a supermarket?

MR. BOISVERT: 80 per cent through organized distribution, integrated in one way or another.

COMMISSIONER GRANT: For the purpose of my percentage I am thinking of the type of grocery store where the customer serves himself and goes through a checking-out system.

MR. BAINARD: They do that in the small highways and byways and crossroads stores. We advocate it because of the saving that they can pass on to the consumer. They have to be competitive. You would hardly describe a small store with $2,000 worth of business a week as a supermarket, which is a store with 16 check-outs and which takes in $1 million a year.

THE CHAIRMAN: I suppose one can distinguish between those retailers who in fact own the wholesale facilities and those who are part of your retailer-wholesaler team and do not own the wholesale facilities? I am thinking of large chains.

MR. BAINARD: In the food business there are very, very few retailers who own their own wholesale. That is not true with some of the lines.

In Mr. Jones' organization, for example, there are 1,800 retailers who own the limited company. That is in the drug field.

COMMISSIONER MILNE: There has been a trend, I believe, possibly more in foods, for a wholesaler to obtain a large retail outlet quite different from the independent store. These would still be considered wholesale sales?

MR. BAINARD: No, I would think they would be retail sales. If a wholesaler owned retail stores he would have to report them as retail sales. As a matter of fact, there was a movement a little while ago in the wholesale food line where a wholesaler would own more and more of his own outlets. We burned our fingers in most of them. The thing now is to get out of the retail field and stay out of the retail field. The company I work for is the largest retailer and we own six of these stores and we are trying to get rid of them.

COMMISSIONER WALLS: In your introductory paragraph you say:

> " The Canadian Wholesale Council consists of 'any person, firm, association, or corporation engaged in wholesale distribution in Canada'."

Does this mean, then, that manufacturers who are carrying on wholesale functions are members of your organization?

MR. BAINARD: I do not know of any manu-

facturers. I have mentioned these gentlemen here today, for example, who are Secretary-Directors or Secretary-Managers of organizations. When they are here, they are representing a very, very large number of people. That is the reason they are here, because of their large representation.

COMMISSIONER WALLS: I appreciate that, but I just wondered, as there are a number of manufacturers who are wholesalers, if they had taken advantage of becoming members of your organization?

MR. BAINARD: No.

MR. NEAR: There are two common topics of conversation today. One is that it looks like rain and the other is that the wholesale industry is on the decline. I am just saying this facetiously, I know, but unfortunately I have not been able to give you any of our Canadian statistics although in the States they are very complete. I think it is fair to say we follow the trend in the States. They show that in 1939 the wholesaling industry in the States distributed some $238 million, and that in 1954, it was $101 billion. If I had the up to date figures it would show about $180 billion in the States today. So that the wholesale industry is not declining, it is increasing.

One thing rather astonishing about it and one of the recent remarks that our late friend Mr. Kennedy made was that one of the things about the wholesaling industry is that it is the only industry which has held its price, which has held its overhead. As Mr. Bainard has said, we have become more competitive. We find that the wholesaling industry is now handling double the sales with a lot less employees than formerly, which is attributed to more efficiency in their handling. I have been doing a little research for the Wholesale Hardware Association, and I discovered that back in 1899 when it was first formed people said then that the wholesaler was on the decline and would not be too long with us. That was in 1899 and the hardware industry is stronger today than it has ever been. It has a lot of perils facing it, we know, but it is as strong as it ever has been. It is a question of the survival of the independent businessman.

He cannot survive unless he has a wholesaler who can economically do it. We have mass production and mass distribution which the manufacturer cannot give us.

THE CHAIRMAN: Thank you very much indeed.

MR. BAINARD: In the Dominion Bureau of Statistics publication in January, 1963, No. 63008, they compared the estimated annual wholesale trade for 1960-1962 in percentage changes in millions of dollars. It indicates the total of trading wholesale and shows an increase of 10.9 per cent.

THE CHAIRMAN: I would not know whether that was good or bad.

MR. BAINARD: Well, it answers the question whether the wholesale trade is on the way out.

THE CHAIRMAN: My question was directed to you originally only as to its relative position, whether it was improving or declining. A ten per cent increase over two years sounds all right to me, but I do not know whether that is better than average or better than the total trade of Canada or less than the total trade of Canada. I do not think you know either. You cannot tell, can you?

MR. BAINARD: No, I cannot make a comparison for you.

THE CHAIRMAN: Anyway it is not 10 per cent in two years.

MR. BAINARD: That is so.

THE CHAIRMAN: With regard to sales tax, this is a very important matter. We have had many representations made to us to the effect that if one seeks to tax the consumer then the tax should be

levied at the consumer level, such as is done by the provinces. That has been put to us many times.

The arguments which support that are, one, that the consumer would then bear the taxes as intended, in proportion to his taxable purchases, because the amount of tax borne by the consumer would not be affected by the mark-ups from one level to another which are being imposed at the time the consumer spends his money. What is more, if it was put on that level it would not be paid by other people, being charged from one to the other and finally being charged against the consumer, the other people being out the tax in the meantime, assuming that they had to pay the tax at the time.

It has also been suggested that it be combined with the provincial taxes. Some people have suggested that it be imposed as a separate levy, probably as a hidden tax rather than brought to light. We have had a lot of suggestions around that point. I think I can say generally that they all recognize that the cost of collecting at the retail level would be greater as the provincial governments costs are. Some people say that there are 350,000 retailers to collect from, but anyhow there are a lot, I know. Despite that, the advocates think that it would be in the national interest to absorb the higher cost to do it that way.

On the other hand, I think they all recognize that probably the least possible difficulty in collecting this tax would lie where the least number of licensees are, and that is at the manufacturer's

level. That would be a very cheap tax, generally speaking,to collect. People who do not like that -- and from what we have heard it does not seem to have many friends, although it has one or two -- say that it is pretty uneven at the economic level and that it is hard to apportion it appropriately as between imported and domestic manufacturers goods. It seems to raise difficulties with regard to private brands, and many other things arise.

It has also been suggested, I think, that it be transferred at the wholesaler level, although not very often. The popular suggestion is the retail level. You people deal essentially at the wholesale level, and of course it is only natural that you would know what would happen at the wholesale level. However, before moving on to that, would you feel strongly that it should not be imposed at what I first of all called the consumer's level, and then what I called the retail level, but I mean the point at which the consumer buys his goods, as is done by the provinces?

MR. BAINARD: I can only reply by saying that officially we have no opinion to express on that subject. What you say, is, of course, true as regard the number of representations which have been made, suggesting that it go to the retail or to the consumer level, call it what you will. We have discussed that very frankly in our Council and we decided that we would not express an opinion as we do not feel qualified to do so.

It is true -- at least, I hope it is -- that there have not been very many suggestions made

that it go to the wholesaler level. There are, of course, as we all know, some very great difficulties posed when you discuss the combination of provincial and federal taxes. This is not a time or place to discuss that, and you gentlemen are more familiar with it than I could ever hope to be. But there are very grave difficulties in that.

Frankly, we are presenting the wholesale viewpoint in this brief today in case somebody may decide that there are a lot of arguments in favour of it going to the retail level, but that they cannot do that so it will go to the wholesale level. That is the reason we are presenting the brief.

THE CHAIRMAN: And that is a very fair reason, and it is not unreasonable for you to say that it is at least one choice which is open to the recommendations of the Commission and that the Commission could quite well come down with such a recommendation. As you say, the Committee with which I had something to do some years ago came to the conclusion that it is a better level than the manufacturer's level, and although it was not within the terms of reference of that committee they gently suggested that after due explanation, care and so on, and at some time in the future, it might be possible to impose it at that level. That raised a storm, and I was glad that it did because it seems to me that the only way one could find out about it is to have the matter debated.

COMMISSIONER WALLS: It is a little intriguing to me that during the past week or ten days we have had the Manufacturers Association before

us recommending that the tax should be at the retail level. We have had the Canadian Retail Council who made representations that it should either be at the manufacturing level or at the wholesale level. We now have the wholesalers who want it at the manufacturing level. I think the crux of the whole situation is that no one wants to be the tax collector.

MR. BAINARD: That is undoubtedly true, Mr. Walls. I will have to admit that. But the case we are endeavouring to make today is to show the position of the wholesale-retail team in the distributive field. We have tried to take, although it is difficult to do so, an unselfish view of the situation.

THE CHAIRMAN: Well, we are glad to have what you have put before us. This is just the type of thing we want to know and now we want to test it.

COMMISSIONER WALLS: I should like to deal with your item on page 6, which is excise tax versus sales tax. You draw to the attention the fact that it might still be necessary to collect excise tax at one level and sales tax at another. The other countries who employ a wholesale tax, and there are four major countries who employ a wholesale tax, put their sales tax on a graduated scale. In other words, they have no separate excise tax, because in effect, our excise tax and our sales tax are both sales taxes. So that they collect it at the one level but on a graduated scale, some of them even having as many as five different ranges of ad valorem rate. I do not think that is necessary, but surely it is possible, do you not agree, to get around this matter of excise tax by

having the sales tax on two levels, perhaps?

MR. BAINARD: If you are going to the retail level you would have to collect excise tax there too.

COMMISSIONER WALLS: No. I am dealing with your recommendation that it not be wholesale. I am only dealing with wholesale.

MR. BAINARD: Then you would have to get the wholesaler to collect the excise tax as well as the sales tax.

COMMISSIONER WALLS: No, it would be the one tax. It would be on a graduated scale. As things stand today with excise tax there are so many items at 10 per cent and at 15 per cent, with the exception of tobacco.

THE CHAIRMAN: Yes, and imposed at the wholesale level.

COMMISSIONER WALLS: Australia has three or five, and Switzerland has two, I think. So the point is that if you are going to collect it on the same basis you would add the taxes together on these particular items, and that would be the sales tax on those items.

MR. BAINARD: You would have different rates for different commodities. That is another nice complication.

COMMISSIONER WALLS: Well, we have that now. The manufacturer has too. So, I do not think that there would be a serious problem so far as separating excise and sales tax is concerned.

I should now like to go to page 8, which is

headed "On Simplification". Would you straighten out these figures so that I can understand them a little better. You say that sales at wholesale by wholesalers proper, by manufacturers branches and by agents and brokers during the year 1951 totalled $1,335,737,700, $883,272,800 of which was done by grocery and food specialty wholesaler. Then you seem to separate another group distinct from your previous total by stating that there was another $1,264 million worth of volume effected by groups dealing in perishable foods.

MR. BAINARD: That is to separate meat and produce from groceries.

COMMISSIONER WALLS: I see.

MR. BAINARD: That is the distinction there.

COMMISSIONER WALLS: Now, I am wondering why you are putting this concentration on the difficulty of the sale of foodstuff. First of all, we have never taxed foodstuff in Canada except a very small percentage. Today it is less than one per cent of all foods which are taxable.

At this stage might I just introduce this. I have before me one of our order forms which we hand out to retailers. Perhaps Mr. Bennett would distribute them, with your permission, Mr. Chairman.

THE CHAIRMAN: Yes, thank you.

THE SECRETARY: Do you wish to enter this into the record, Mr. Bainard?

MR. BAINARD: Yes, please.

THE SECRETARY: Then it will be exhibit 313.

--- EXHIBIT 313: Weekly price list issued by National Grocers Company Limited.

COMMISSIONER WALLS: Shall I continue with my question?

MR. BAINARD: Well, perhaps I might make an explanation in a moment or two which I think will answer your question.

The order form which you have in your hand, Mrs. Milne and gentlemen, is the order form which is issued by our Toronto branch, and we have two branches in the provinces who do this sort of thing as well. This form is placed in the hands of the retailers with whom we have these contract arrangements.

First of all the group is mentioned, whatever it may be. This form goes to the retailer and becomes his catalogue showing the resale price. The goods are described, how packed, the suggested retail price. At least it is hardly suggested retail price, because actually it is a chain store retail price which is taken from one of the amber services. Then there are three prices which follow. These three prices depend on the category into which the retailer concerned falls. It depends on the size of his order. At the extreme left hand side the retailers puts in the quantity of the merchandise which he is ordering. That comes to us and we use it as an assembly form going through the warehouse and picking up the merchandise from the form itself. Then it comes back to the office and is extended. It is put through an

adding machine and a tape is placed on it. We have two copies of that; it is done twice. One copy, which we retain, is the only copy which we have, and the form itself with the adding machine tape goes back to the retailer, and we do not have in our possession anything which can be audited, or anything of that kind.

Now, specifically answering your question --

THE CHAIRMAN: Before you do that, I do not understand what you have been saying to us so far. I see this is an order form and so on, and you indicate that the price goes on the right hand side and then the suggested retail price, which you derive from the amber service, covers the last three columns on the right hand side. Is that correct?

MR. BAINARD: Let us take the form from the beginning. It describes the commodity. Next is how packed, how many in a case. I am looking at apple sauce which is packed 24/10, which means 24 ten ounce tins in a case.

COMMISSIONER GRANT: Just to follow your example, which page are you referring to?

MR. BAINARD: I am looking at page 34.

THE CHAIRMAN: Yes, you have apple sauce on the left hand side, Mitchells Fancy.

MR. BAINARD: Yes. You see 24/10 which describes the fact that there are 24 ten ounce tins to a case. Then the pricing system is given, showing ordinary resales, shelf resales not a special sale at weekends. This one is 2/29, which means two for 29 cents. The retailer will buy a case of goods from us, depending on his category, the size of his order.

Naturally we selllower to a man giving us a order for $5,000 than one giving us an order for $500. Depending on the retailers category the price is either $2.98, $2.95 or $2.92 per case.

Let us say that he is in the $2.92 category and orders five cases of Mitchell's apple sauce. This comes into the office and we multiply five times $2.92, which is $14.60, which we extend there. After it is extended it is added twice by an addding machine tape. One tape accompanies this form and goes back to the retailer. The only thing which we have left is the adding machine tape, and we write the price to him, giving the brand of goods, the order, and so much money.

To answer your particular point, Mr. Walls, when you are talking about the wholesale food merchants do not think that they are just selling food alone which is not subject to tax. In the order form which you have in your hand there are 5,312 items. Of those 1,791 are subject to tax.

THE CHAIRMAN: About twenty per cent.

MR. BAINARD: How can you tax at the wholesale levels with a form like that, and how could the government audit it?

COMMISSIONER WALLS: The only thing I would think looking this over, your pages dealing with foodstuffs are together on one page. You might have to set out a separate system for your order form for taxable items. If you do this, I am rather surprised you did not put before us this less than one per cent on foodstuffs which are still untaxed. Then in the vast majority of your particular business you would be able to operate on the same basis as you operate it today.

I agree you would have to evolve a different type of order form for the taxable items.

MR. BAINARD: We would have to have an invoice form which would increase your expenses and increase the retailers costs and therefore make it less competitive.

THE CHAIRMAN: That sounds like a very interesting job to figure out. I happen to be in the systems business.

MR. BOISVERT: It must be observed that the catalogue, all scores, all groups of operations in the country have been engineered for assembly purposes on velocity sequences and would have to go back to less efficient operation to some degree.

COMMISSIONER WALLS: Of course, I think you will agree no matter who is to do the tax collecting, they are going to be faced with some additional administration costs. There is no question about that. The fact some provinces are paying

retailers 3% for collecting money shows it has been recognized at the retail level by the provincial government.

I agree with you and your comment on page 9 that should there be any decision to head towards wholesale tax, and even perhaps if there is no decision, it will be necessary to clearly define what is a wholesaler but you must keep in mind that the definition in the present Act of "what is a manufacturer" is not very clear either.

MR. BAINARD: That is true. Dealing with food, there has been a suggestion which I have seen in one or two briefs that the base be broadened. If it were to be broadened and were to include process food as was the case at one time, you have got a still greater problem.

COMMISSIONER WALLS: In so far as what you do with people who are either manufacturers who are dealing directly with retailers or large retailers who operate their own wholesale business, there have been three different methods, of course, that have been employed in other countries.

Under the manufacturers tax, a manufacturer selling direct to a retailer has his selling price discounted. Under the wholesale tax, the retailer performing also the functions of a wholesaler or manufacturer has his price uplifted which really both amount to the same thing, whether you discount from one person or uplift from another.

In at least one country with wholesale tax, the retailer is licensed and has the option of paying either a lower ad valorem tax on their retail sales, if they prefer that as against having an uplift on what would be their wholesale price.

There have been methods that have been devised by these countries that are being studied by our research staff just as they are studying all types of sales tax. There are methods by which you can include these adjustments between the trade that are bypassing the regular wholesale, one way or another.

MR. BAINARD: It seems to me sensible. It would have to be kept on a fair competitive basis between the two main methods of distribution. There would be complications of costs and expenses of doing it and efficiency of the auditing from the government viewpoint.

THE CHAIRMAN: It is a matter of weighing up the complications, difficulties, unevenness, and fairness of one method against the other. The manufacturer's tax is something that is known, of course. It has got the benefit of having had a lot of the bugs worked out, as far as it is possible to work them out. Many people think they should be left there.

MR. BOISVERT: Another ingredient, sir, and not mentioned here, it is a definite asset to this competitive system of ours to a degree equal to the United States and perhaps to a degree to the

advantage that the wholesalers have getting their goods at the same price which is a saving point.

As far as the competitive team is concerned we take care to see what our chain store operations are doing because we know at the starting line we are all even. There are quality discounts we can qualify for them by pooling. This is a tremendous advantage in a competitive system such as ours which is dynamic and growing. Probably because of that that would be disturbed or thrown out of balance if tax interfered because tax has a great psychological potent.

THE CHAIRMAN: You are working on a narrow margin.

MR. BOISVERT: Yes.

COMMISSIONER WALLS: On page 10 you have a lot of very good reasons as to the difficulties that may be encountered by selling on a wholesale basis or collecting taxes, I should say, on a wholesale basis but it might be just as well to review one or two of the advantages at the same time and get your reactions to them. For instance, first of all the wholesale tax does away with the present unlicensed wholesale branch under the Manufacturers Tax where they have to pay taxes before they either sell the goods or realize on them. If it was a wholesale tax the tax would not be collected until thirty days after the sale of the item.

The unlicensed wholesale branches at the present time have to pay taxes when they receive the goods and they have their whole inventory already carrying taxes and then have a thirty day wait at least after that so I think that would be one advantage. Do you agree?

MR. BAINARD: I would suspect our friends in the government who collect the taxes would say they are not going to get the taxes as quickly therefore it is going to cost them some interest. The Department of Finance might argue on that point.

THE CHAIRMAN: I don't think they can produce an argument in equity.

MR. NEAR: Mr. Walls, the other day I was speaking to one hardware wholesaler. He has three people working on taxes. He would be very glad to get rid of three people because that is all overhead.

COMMISSIONER WALLS: Yes, the Retail Council told us how many people they have to have in the stores and how much trading they would have to get there.

MR. BAINARD: You will note in item C on page 10 "cash and carry". That is a fairly new departure in the wholesale trade but you can see the reason for the cash and carry department. This puts us in a more competitive position to the buyer. He comes down and makes a cash and carry sale just as he would in a supermarket. He doesn't

get any invoice. He just goes around and he collects his merchandise and it goes to the cash register.

THE CHAIRMAN: Is this done in cities?

MR. BAINARD: Well, it is done in more than cities. Our company have 32 wholesale branches and we have 29 cash and carry departments.

THE CHAIRMAN: Do you really?

MR. BAINARD: That is correct.

THE CHAIRMAN: Do you mean a small merchant enters into your warehouses and wanders around just as a consumer would in a supermarket?

MR. BAINARD: Yes. He wanders up and down the aisles. He picks out his merchandise just as a woman does at the supermarket, puts it in a little carrier, takes it to the cash register, the cash register is run up exactly the way it is in a supermarket; puts it in his conveyance and away he goes.

THE CHAIRMAN: I have seen that done in the soft goods wholesale. I didn't know it had gone beyond that.

MR. BAINARD: We have 29 stores in our company and we are not the only company with a cash and carry business.

COMMISSIONER GRANT: As a matter of interest, he would be identified as a retailer before he was allowed to purchase from you.

MR. BAINARD: Yes. We only sell to retailers. As a matter of fact we only -- we don't

wish to sell to anybody who has not a sales tax licence by the way. We don't want to collect taxes. If we did we would have to collect them to remit them. We limit it to a list of people that are legitimate retailers. We have their names recorded. We have their licence number recorded. If an ordinary consumer came in we would say, "Sorry, we won't sell to you".

COMMISSIONER GRANT: In other words they have to be identified to your satisfaction?

MR. BAINARD: That is correct.

COMMISSIONER WALLS: I fully agree we are fully indebted to you for outlining all these methods, many of which we have not encountered before. The fact I am not dealing with them does not mean that we have not read and have not studied them and our research staff are not already working on them.

I would like to go on with some of the other advantages that people who recommend the wholesale tax put to us and get your reaction on them. The next one was that if the intention of the government should be to retain the same amount of revenues from sales tax as we have today, then instead of an 11% tax, it is estimated by Professor Chew (?) that at the wholesale level it would only have to be a 9% tax so it would mean a reduction on the tax amount or rather on the tax percentage.

MR. BAINARD: Not on the amount. That is the important thing. Aren't we sort of kidding

ourselves?

COMMISSIONER WALLS: Do we not like to?

MR. BAINARD: Well, maybe Barnum was right.

COMMISSIONER WALLS: Another one, this is quite important, we hear quite a lot of it and that is that the sales tax would avoid disparity between imported products and those manufactured in Canada. For instance, imported goods are sometimes purchased abroad at prices which omit some of the distribution charges that manufacturers in Canada are faced with and included in his sales tax.

Then, goods imported in bulk and packaged in Canada. The Act as it now reads is that a Canadian manufacturer has to pay sales tax on the package on taxable goods. That only applies to manufacturers with the exception of about five articles, which I will deal with in a minute.

If they are bought in bulk from another country and re-packaged in Canada these goods escape that tax but, of course, if it was moved forward to either the wholesale level or the retail level then they would be put on an equitable basis.

MR. BAINARD: Against that there are many importations which move directly into the retailers' hands.

COMMISSIONER WALLS: In that case they would be treated by the uplift method I mentioned earlier. If it was a retail tax they would be caught

where they are not caught at the manufacturers level. You see, a manufacturer in his sales tax has to also include such things as finance charges, advertising, and the charges that are not faced in most cases by a broker who is importing or an agent who is importing products from foreign countries so that it would create better equalization. In fact, in some countries they have put on an additional tax at the point of entry in order to try to equalize.

MR. BAINARD: Of course, I think it is apparent -- nothing is impossible -- if you are going to do that you are faced with special rulings and special things, special cases, special items. You have them now.

THE CHAIRMAN: Do you know how many there are now?

MR. BAINARD: How many?

THE CHAIRMAN: I am told there are about 800 a month.

MR. BAINARD: There are a lot of them. I have forgotten how many thousands we had last year.

MR. BOISVERT: Fourteen thousand.

MR. BAINARD: So the further you get away from the present level into the wholesale level more complications and rulings are going to take place. For instance, in a case of soap sold in Hamilton to a chain store we will say in

Sault Ste. Marie the manufacturer doesn't pay sales tax on the freight.

COMMISSIONER WALLS: Unless he uses his own transportation.

MR. BAINARD: That is right. He wouldn't do that to Sault Ste. Marie so he doesn't pay taxes on that. Now, if we put the cost to the wholesale level the wholesaler is required to have a licence to purchase free of tax. He pays the transportation if he is situated in Sault Ste. Marie and adds his cost of doing business and he pays tax on that so now you are forced to a special ruling to cover chain stores who buy at the manufacturers level and who pay taxes and then between Sault Ste. Marie and Timmins, between Timmins and Windsor and between Windsor and Brantford.

COMMISSIONER WALLS: We might have to give consideration to this whole problem of transportation so as to avoid disparity between the legitimate wholesaler and the manufacturer selling direct to a retailer. Some consideration has been given to it. I think you might have to remove the freight between the manufacturer and the wholesaler, that portion between the manufacturer and the wholesaler which would then mean that all that would be taxable on your goods would be the freight through to the retailer and the manufacturer would have to pay the tax from himself to the retailer.

MR. BAINARD: This would bring about

one lovely complication with the wholesaler making the computation.

COMMISSIONER WALLS: We have complications no matter which branch we look at in this sales tax.

MR. BAINARD: I agree. I think you have less of it at the wholesale level.

COMMISSIONER WALLS: You may be right. I made mention to you a few minutes ago about this bulk packaging of goods and your brief seems to me, with all due respect to our Chairman, it intimated the government had not acted on the 1955 commission. I would point out there were two things there that dealt with bulk packaging of medicine and pharaceuticals which were recommended there. Now, all bulk packagers of both pharmaceuticals and drugs are in effect called manufacturers and pay a tax from that level. That was something quite worth while that came out of that Commission.

MR. BAINARD: I think Mr. Jones would probably agree on that.

COMMISSIONER WALLS: There is another point. I don't know whether you know too much about it but from our standpoint there would be a certain amount of advantage both in the administration and assessment in moving the tax forward to either the wholesaler or the retailer from the manufacturer to get away from this problem where a product is sold and goes into two or three different levels of manufacture before it turns into the final product so

we would escape all that administrative end if we moved the tax forward, but I would not expect you to be able to say very much about that.

MR. BAINARD: No,except again I think Mr. Boisvert has made the point quite well if we go to the wholesale level you are still going to licence all these manufacturers and wholesalers as well and you will get a large number of people who are licensed to collect tax.

THE CHAIRMAN: That is quite true.

MR. BAINARD: That is going to add to the level of government.

THE CHAIRMAN: Well, I have always thought that it is necessary to find the selling price for a huge humber of situations where it is not fair to use the actual selling price.

MR. BAINARD: That is right.

THE CHAIRMAN: As you know, the authority does not seem to be very clear for changing the selling price. It is done by a discount.

MR. BAINARD: These regulations are made in order to be fair.

THE CHAIRMAN: That is right. The discount system is an extremely difficult one. They take the average for industries and apply discount to the industries. Some people fit the average fairly well and others do not fit quite as well. It is a very honest and industrious attempt to achieve fairness.

MR. BAINARD: I quite agree with you, sir,

I think it is an honest attempt.

THE CHAIRMAN: I think at the manufacturers level it must be that there are more goods which use cubic rather than real prices than at any other level. Certainly if one goes to the consumer level there are few cases that have to be considered, if any. Probably none. From the manufacturers level you go to the wholesaler. There has to be something else fit into it at the wholesale level. There would have to be adjustments where the wholesaler will adjust directly to the consumer. I would have thought there would be no problem in these adjustments. You could shrink a huge number down to a small part. The wholesale tax would be a fairly easy tax if everything went through to the wholesaler.

MR. BAINARD: Yes.

THE CHAIRMAN: If they did not go through the wholesaler, it seems to me the next best level where most goods go to the consumer, where everything goes, the next best level would be where the retail price is given, irrespective of from whom he buys. That is all I am saying as far as a real basis is concerned.

You put against that the difficulties which arise against your own interests, which may be perfectly true; but I think this has to be considered.

COMMISSIONER WALLS: On page 12 you deal with the additional costs of collection, the additional assessment. I do not think there is any doubt that it will cost more to collect. But is that such a very great factor when you consider that the provinces are collecting at retail from a very much smaller percentage of people on a great many more accounts, and I understand they are doing it on an average of 3 per cent; that is, 3 per cent of the total tax take is the total cost of this assessment and collection.

In your case, with much larger firms, and a much smaller number, your collection costs would be considerably lower than that, although I will agree not as low as the manufacturer. So I do not think that really the collection or assessment costs are going to be that much out of line.

MR. BAINARD: The extent to which any cost is added in the wholesaler-retailer team of course becomes a matter of concern. As Mr. Carter so well said, the merchant in this business is so very, very small; you are dealing with pennies. Any extra cost is against the plan, as compared with the competition.

MR. BOISVERT: If I may go along with that, we are getting to equity again. In

our particular food industry merchants may vary from as low as a 3 per cent mark-up to the larger buying organizations where it is up to 7 or 8 per cent. These people make small sales, because that is 20 per cent of the over-all distribution, which is most complicated and the costliest, and because of that most of their consumers pay a little more and would be penalized to that extra extent over and above the large merchant. We run into equity problems again there and we run counterwise to what was aimed for in the first place.

THE CHAIRMAN: I do not think I follow you, Mr. Boisvert. I can see that if, of course, collection is uneven it is going to upset trade; but if it affects all merchants in roughly the same way, I would not have thought it would make much difference.

Mind you, there is some precedent -- although I do not say this would be the right thing to do under these circumstances -- for reimbursement for that cost.

COMMISSIONER WALLS: Once again, Mr. Boisvert, you are representing the grocery industry. You are thinking, again, of quoting these rates or percentages in terms of food, and again we must go back to the fact that I know of only one country that collects sales tax in any form today that does not exempt food. Also, the present taxable food items in Canada amount to less than one per cent of the total food volume. Really,

these small merchants are not pertinent to the case as it stands today.

MR. BAINARD: But in the food industry we sell more than food, as has been said.

THE CHAIRMAN: Yes, we know of your 1,000 items.

COMMISSIONER WALLS: But I think you will agree that your non-food items carry a larger margin of profit, do they not?

MR. BAINARD: That is true; they do not move as rapidly.

MR. BOISVERT: Going to incidental sales, we might sell taxable goods, cleaning materials and things of that kind, which might go up to 12 or 15 per cent.

MR. BAINARD: Time is running out on us, sir. We have used our hour.

THE CHAIRMAN: This is an important matter; we are going over the hour, if you do not mind.

MR. BAINARD: We will be happy to spend as much time as you wish. I do wish to say something about the organization at the end, if you will allow me to do so.

THE CHAIRMAN: Yes.

COMMISSIONER WALLS: I think most of the other points we have covered. You deal with transportation and alternatives have been mentioned. One thing that is not in your brief is this, that where a manufacturer uses his own transportation --

and a grocery manufacturer would, to quite a considerable extent -- it is not tax exempt.

MR. BAINARD: I do not know how the grocery manufacturer handles this. I am thinking of a large company in Ontario, for example, which does its own transportation. It is a separate company. It happens to act for them, but it is a separate limited liability company and I would not consider it as manufacturing.

COMMISSIONER WALLS: I imagine you could be correct in that, but on this matter of transportation and equalization between them --

MR. BAINARD: By and large, the manufacturers do not move their own merchandise in our line of business to their wholesale warehouses. They employ different means. It is a very difficult thing to get a back haul; that is the reason for that.

MR. BOISVERT: On transportation I would say this. Much merchandise is delivered by the manufacturer on an f.o.b. destination basis. How do we separate the freight tax from the price so as to avoid paying tax on it or collecting tax?

COMMISSIONER WALLS: Would the selling price not be based on the f.o.b. price, and indirectly you would be paying the tax on the transportation anyway?

MR. BOISVERT: Merchandise sold by manufacturers to us is on an f.o.b. destination basis, again for the sake of equalizing the competitive factors.

MR. BAINARD: Merchandise sold on a delivered price basis does not bear the tax. The estimated cost of delivery is taken out before the sales tax is computed.

COMMISSIONER WALLS: That is quite correct.

THE CHAIRMAN: I think that completes our questions on sales tax. The other part of your submission is rather easy to understand and I do not think we need ask questions about it.

Mr. Bainard, you said you had something you wished to put to us.

MR. BAINARD: I wanted to refer to the summary on page 20, Mr. Chairman, and point out the concern of both Conservative and Liberal governments. The present Liberal government is concerned with this question. Therefore, I think politics has nothing to do with it. I am very happy to say that. I refer to the concern of governments for the position of small business, which they agree should be recognized and it is important that it be recognized.

I had a great deal to do with representations which were first of all made to a Liberal administration and then to a Conservative administration which resulted in the passage of Bill C-40 which sought to help the small businessman. At a later date, because of the fact that there were some limitations to that, the Industrial Development Bank was opened to that class of business. Originally wholesalers and retailers were prohibited

from using the Industrial Development Bank because of the limitation placed by C-40. The I.D.B. was made available to them. That was done in an effort to look after a section of the economy which governments -- and I have used the plural -- thought very, very important.

They followed the lead, I suppose, of the small business administration in Washington, which long before we acted in this country did the same thing. The point I am trying to stress is going back to what I said at the beginning, that there are many means of merchandise reaching the ultimate consumer, but the two main sources are those which we have mentioned in our brief, and whether it is 60 per cent of the business that goes through the wholesaler-retailer team, or whether it is 50 per cent, it is a tremendous percentage and we should be very, very careful in governing this whole thing. We must be very, very careful that we protect that very important segment of our national economy. It is vital for a country such as we are, sir, as many miles across as we are, with a number of small hamlets, villages, towns and rural sections.

I did wish to emphasize what we have tried to put before you in the brief.

THE CHAIRMAN: I think you have said it very well indeed, Mr. Bäinard, and I think we understand the point most clearly.

MR. BAINARD: Thank you, Mr. Chairman.

THE CHAIRMAN: We are indeed seized with the fact that the cost of administering taxation should not be excessive; that taxes should be levied and collected in the most economical manner possible; and I think we are also aware of the fact that it is not possible to levy taxes without causing people trouble. One does not want to add to the trouble; one wants to reduce it.

But certainly we are all confronted with considerable trouble in paying our taxes, and I can assure you that we will bear in mind, in making our recommendations, exactly what you have put before us. We will have regard to what you have put before us, to what the manufacturers have put before us, and to what the retailers have put before us, and we will try to work out that which we think is the best course in this very troubled area.

We will take our time and we will look at precedents elsewhere, and it may be that our staff would like some assistance from your organization.

MR. BAINARD: I am glad you mentioned that, Mr. Chairman, because I was about to make that offer and say that anything we can be of service to you in, with regard to answering any questions you wish to ask of us, we will be very glad to do. As I said in the beginning, we are really representative and I think in our group

we could get intelligent answers to any questions that you might wish to ask, as they affect our various types of business.

We would be very happy to be at your disposal, or at the disposal of anybody else, if the department that is administering it will give us a call.

THE CHAIRMAN: Thank you very much, Mr. Bainard.

MR. BAINARD: We are no experts on corporation tax, Mr. Chairman, but I still think that Micawber was right.

THE CHAIRMAN: Yes, I see that you have put that in.

MR. BAINARD: Thank you, sir.

THE CHAIRMAN: Thank you very much indeed. We will break for ten minutes.

--- Short recess.

SUBMISSION TO THE ROYAL
COMMISSION ON TAXATION BY
THE NATIONAL FARMERS UNION

APPEARANCES: Mr. A.P. Gleave

THE SECRETARY: The second brief this morning, Mr. Chairman, is being presented by the National Farmers Union. Mr. A.P. Gleave, President, is here to speak to the brief, which I will now enter into the record as Exhibit 314.

EXHIBIT 314: Brief of National Farmers Union.

THE CHAIRMAN: Thank you. Good morning, Mr. Gleave. Thank you for your submission to us. We have a few questions to put to you. We have all read your brief with interest. Before asking you any questions, is there anything you would like to say to us by way of summary or amplification?

MR. GLEAVE: No, Mr. Chairman. In Saskatchewan and Manitoba we have income tax offices in each of these two unions which some of our membership use to file through. In the specific things which we have placed in this brief, we drew largely on these two offices and the experience which they had had.

I might say that I had planned to have the head of one of these offices with me this morning, but this happens to be the busy time for filing. The load is now coming on with regard to

filing, and there are country meetings, and I just could not bring him along. I am sorry, because these are the people who technically handle this matter.

THE CHAIRMAN: Very well. We will expect you to answer our questions.

MR. GLEAVE: I will do the best I can. If I get bogged down I will say so.

THE CHAIRMAN: Well, I am delighted that you see it in that way. We have the factual experience of your people who are dealing with these tax problems day in and day out. I thought that we would go to your specific recommendations, which start at paragraph 21. There you make a recommendation with regard to dividend tax credits. I am a little curious about this. You suggest that interest on bonds be given the same 20% tax credit as dividends from stocks.

MR.GLEAVE: This came from one of our provincial unions. I think that their main thinking here was that this would facilitate borrowing by local governments, municipalities and so on. This was their main reasoning behind that recommendation.

THE CHAIRMAN: One of the main purposes of this is that it requires Canadians to buy Canadian stocks, to try to funnel more savings into equities because Canadians were not buying as many equities as would be good in the national interest.

MR. GLEAVE: Would not the same apply to municipal debentures, shall we say? For example,

schools go to people to borrow money. Are they not in competition with the market for those who have capital to lend?

THE CHAIRMAN: They are indeed, but this would discriminate in favour of stocks, so that where there is a supply of money available to buy securities it would move more in the area of stocks than it would in the area of bonds. That is why it was put in. If you wish to challenge the principle, fine. Is it a bad principle? I do not know. We often hear that Canadians do not participate in equities to the fullest possible extent.

MR. GLEAVE: Well, I do not know why Canadians do or do not buy equities, or whether they do or do not buy municipal and school debentures, and so on. Probably many private reasons enter into it, but our thinking was that if the same tax credit was applied for the bonds it would make attractive the municipal ones. That is why we put it in.

COMMISSIONER GRANT: On that point, if I might make another comment, Mr. Chairman, on the principle involved in this section 21, if you look at the other end, this source of the bond interest, you will appreciate the fact that bond interest is allowed as a deduction by the corporation if it is a corporate bond before tax, whereas dividends are paid out of income on which tax has been paid.

MR. GLEAVE: Yes, I get your point.

COMMISSIONER GRANT: So from the issuing

point of view there is quite a distinction between the bond and the dividend, the interest on the bond or the dividend or stock.

THE CHAIRMAN: I think we have Mr. Gleave's thinking now. At least, I understood that you made it very clear that from your point of view you thought that the investor should be in a neutral position as between bonds and equities. Is that why you put it in the brief?

MR. GLEAVE: Yes, that was our point.

COMMISSIONER GRANT: Of course, the double taxation element comes in here and is shown up very well in the bond and in the stock. No tax has been paid on that bond interest up to the time it is in the hands of the recipient.

MR. GLEAVE: Yes, that is true.

THE CHAIRMAN: I think we might skip incentives, unless anyone has anything there, but I am very much interested in depreciation allowance. You suggest that the 5% maximum depreciation allowance in respect of farm dwellings and buildings is not sufficient for buildings used to store grain. You also include livestock buildings. You recommend that the rate be set at 10% maximum annually and that he be allowed deprecation on a straight line basis, which would give him a ten year write-off rather than a twenty year write-off. Are not farm buildings designed to last 20 years?

MR. GLEAVE: Yes and no. Certainly they are in terms of houses, dwellings. Our thinking

here was that we are now, let us say, for example in livestock housing, getting changes in methods of housing. We are getting more modern, more mechanized. Technologically we are advancing. It is our feeling that these changes, as we go along, will render our handling facilities obsolete faster. I refer to methods of feeding, handling feeding materials and so on. We feel that you cannot assume any more that you will build a building for some of these purposes which will still be as efficient 20 years from now. In fact, the chances are that it may not and that changes will have to take place.

THE CHAIRMAN: I thought you were illustrating the matter by going to equipment which you use.

MR. GLEAVE: Yes, in part. But it could also refer to actual buildings.

THE CHAIRMAN: Let us stay with the buildings because you are addressing yourself to that.

MR. GLEAVE: Yes.

COMMISSIONER WALLS: Is it a fact that since the return to increased livestock raising in Canada on the recommendation of the government much of this today is done under shed covering entirely rather than a permanent building?

MR. GLEAVE: Yes.

COMMISSIONER WALLS: The same, I presume, also applies with recent heavy storage of grain. You have had to build grain storage space for a

comparatively temporary period, rather than on the basis of a permanent building.

MR. GLEAVE: When you look at grain storage, some of it is temporary, that is true. However, again we think that in regard to storage of grain the type of storage has changed, and may continue to change, and that the stress on the buildings will render them so that they depreciate faster than the dwellings. That is our point.

THE CHAIRMAN: Is there any evidence to suggest that buildings are wearing out in 10 years rather than 20?

MR. GLEAVE: I do not know how you could get evidence.

THE CHAIRMAN: Well, you would see it.

MR. GLEAVE: Well, we cannot produce it. I can say that on the farm the general use, the wear and tear, is harder on grain storage buildings than it is on dwellings, for example.

THE CHAIRMAN: Well, you see them all the time. You come from that part of the world.

MR. GLEAVE: That is right.

THE CHAIRMAN: Do you see cases where in 10 years buildings have worn out and should be scrapped?

MR. GLEAVE: I would not say they would have to be scrapped in 10 years. You could continue to use them, but in my own case, granaries which I built in 1948, let us say the foundations now

which I thought were quite adequate when I put them in, will have in some cases to be rebuilt. You could quite possibly, by sufficient repair, keep it in operation, but it might be to better advantage at the time to replace them.

COMMISSIONER WALLS: I should like to add to that, because I believe in Denmark, the U.K. and Australia they all found the same thing and they had to increase depreciation. In fact they have doubled it in those countries. However, there is one question which disturbs me a little in that this request is based on straight line depreciation, whereas my understanding from the Department of National Revenue is that today most farmers use the diminishing balance method, which takes care of that to some extent.

MR. GLEAVE: I discussed this with the chap who is the head of the income tax department in Saskatchewan, and he told me that most farmers were using the straight line and that there were very few coming through his department who were using diminishing balance. Are you speaking of buildings now?

COMMISSIONER GRANT: Is it not the same whether you use straight line or capital cost on buildings?

THE CHAIRMAN: No, it is a different rate.

COMMISSIONER WALLS: Yes, it would have

to be.

MR. GLEAVE: The information I got was that most of them were using the straight line basis.

THE CHAIRMAN: That with regard to buildings most of them were using the straight line?

MR. GLEAVE: Yes. I believe that if you use the straight line I do not think you can use one on buildings and the other on machinery. If you elect to use the straight line method or the diminishing balance method, that has to be your pattern on everything.

COMMISSIONER WALLS: That is so.

MR. GLEAVE: We discussed that and he said that most of our people are using straight line.

THE CHAIRMAN: Why do not the farmers themselves change over to the diminishing balance like the rest of Canada?

MR. GLEAVE: Why don't they go to the diminishing balance?

THE CHAIRMAN: Yes.

MR. GLEAVE: Well, his information to me was that the straight line gave them a faster depreciation. That is one thing. Also, it was to their financial advantage.

THE CHAIRMAN: Well, if you remember when diminishing balance was introduced in 1948, what happened was that the diminishing balance rates were set in every case, as far as I am aware, at double

the straight line rates. So that in the first three or four years, using the diminishing balance, you get a much greater write-off than you did on the straight line, but in the last year you get a lesser write-off. It came down faster. I would have thought that a good deal of what is asked for in this brief would have been accomplished by using the diminishing balance.

MR. GLEAVE: As I say, this was the practice in that province. I recall a number of years ago discussing with the income tax man which we had there whether I myself on my farm could switch from straight line to diminishing balance, and he gave me all the arguments why I should not.

COMMISSIONER GRANT: Is not one of the strongest arguments which has influenced the farmer that if he takes straight line he is not subject to any recapture tax?

MR. GLEAVE: Yes.

COMMISSIONER GRANT: And that applies to his farm buildings in the event of sale, to his house as well as to machinery which has been turned in on new machinery.

MR. GLEAVE: I think also the straight line is a simpler thing for the farmer.

THE CHAIRMAN: That I have some doubts about. The diminishing balance was introduced because one of the strongest arguments in favour of it was that it was more simple for the assessors, not the taxpayers but the assessors. If it was more simple for the assessors I cannot believe that it was more

difficult for the taxpayers. It results in only one balance instead of two. With the straight line method you must record and maintain the balance of your assets and the balance of your depreciation, whereas with the diminishing balance method the two are put together and carried forward in the one balance. I think you will find that most people who use diminishing balance how acknowledge that it is a pretty simple way to proceed. But I think it is the recapture element which works against the farmer's interests, and I am not sure that the farmer should not be subject to recapture depreciation on the sale of his assets, as is the rest of the community.

MR. GLEAVE: Our income tax man also informed me that several of our people who were using other than the straight line were not too happy with it.

THE CHAIRMAN: I think recapture is probably the reason for that.

MR. GLEAVE: That may have been so, but this was the information he gave me from his experience, that most farmers prefer straight line. Those who had taken the other choice some years ago were now rather sorry that they had, he said.

THE CHAIRMAN: I would have thought it very clear that since that time real estate generally has been increasing in value, and on the sale of their assets they suffer recapture and tax on depreciation which they claim.

MR. GLEAVE: There is the thing here

that other than machinery the farmer's biggest asset is land, which does not enter into the depreciation picture.

COMMISSIONER GRANT: Straight line is, of course, available to every taxpayer, is it not?

THE CHAIRMAN: No.

COMMISSIONER WALLS: Just farmers and fishermen.

THE CHAIRMAN: The farmers and fishermen are put in a special category with regard to this, and if they take straight line they are not subject to recapture.

COMMISSIONER GRANT: I thought that straight line was available to everyone.

THE CHAIRMAN: No. Now, in paragraph 26 you find fault with the averaging provision because it is being denied farmers, either because he had not filed in a previous non-taxable year or because of late filing in one or more years. Surely the remedy for that lies in the farmer's hands?

MR. GLEAVE: Yes, it does lie in his hands, but there are circumstances which are important here. For example, the income tax man cited one to me the day before I left. This particular farmer had been in the habit of filing and did file regularly. He sought to average this year and in one of the previous five years our income tax office had made up his return, he was not taxable and had returned it to him for signature and filing. He had not turned it in apparently. This is not for sure; the

income tax consultant was going to check further into it. But because this particular return had not gone in, then he could not use that year for his five-year averaging.

Our thought here is that we do not think necessarily that this should be a bar to his using it. If he has a return available and it can be established as proper, we see no reason why he should be barred on a technicality, or what we regard as a technicality.

THE CHAIRMAN: Are you sure that he is barred in accordance with the law?

MR. GLEAVE: Yes.

THE CHAIRMAN: Can you quote the section?

MR. GLEAVE: No, I cannot quote you the section, but I do not think there is any doubt about this. If a record is not filed fully in each of those five years, then he has to drop that year in which he has not filed.

THE CHAIRMAN: I agree that he has to get his return in, but I am not sure whether he has to get it in within the usual filing date when he has a loss.

MR. GLEAVE: That was the information I was given. I was given the particular instance. If you wish to check ---

THE CHAIRMAN: Yes, we will check it.

COMMISSIONER WALLS: One of the troubles which we are up against here is that a number of other

risk occupations and a number of professional people with highly fluctuating salaries have come before us and said that they want us to give them what the farmers and fishermen have. They want the five-year averaging, which makes it difficult to stretch that five years any further.

MR. GLEAVE: Yes, I see your point there, Mr. Walls.

THE CHAIRMAN: I think we might skip paragraph 28 and move on to paragraph 30, the chief source of income, which might be said to include the hobby farmer, I suppose?

MR. GLEAVE: Yes, it does.

THE CHAIRMAN: You have been asked by our staff: "Should the qualification for tax treatment as a farmer depend upon the 'chief source of income' rule?" You have some doubts about that.

MR. GLEAVE: Yes. The research department specifically asked this question. It is a difficult area, but nonetheless an important one.

THE CHAIRMAN: Indeed it is.

MR. GLEAVE: Because it reaches into a number of areas. You have the farmer who has a small farm and has to seek other income. We were concerned that no hardship devolve upon him because of his position. Generally the position we arrived at was that as long as the farmer could establish that he was a farmer, he was taxed on that part of his operations as a farmer. With regard to hobby farming,

I think our general point of view would be that if he was a hobby farmer, tax him on his farming operation; but if he is definitely a hobby farmer, and I think this is important, then his losses should not be charged back.

THE CHAIRMAN: My friends, who are hobby farmers, will certainly not admit to me they are hobby farmers even though I may think they are. How do you determine a man is a hobby farmer?

MR. GLEAVE: Well, again, this is the question I put to our income tax man. I said to him "How do you know when he is?" Apparently the Income Tax Department differentiate now. They have a rough yardstick.

COMMISSIONER WALLS: Section 13, of course, says the minister may determine if a taxpayer source of income is neither farming nor a combination of farming and some other occupation, it gives him that allowance to make that decision.

MR. GLEAVE: Yes, it does. We say here:

> "Where the farming operation of the individual is clearly a hobby as related to his occupation or source of income."

Now, if you attempt to define hobby farmer at all, I suppose the income tax people will have to do that.

THE CHAIRMAN: I do not know how they are going to do it. I can think of friends of mine with a thousand acres in Ontario that has got a huge revenue from his farm. I suspect the cost of that farm, even if the revenue is large, is greater. He comes out with a pretty substantial loss. He has got a very substantial effort. Is it fair to allow deduction of the losses against other income. He is certainly would not consider he is only a hobby farmer. He would say he is a real farmer -- look at the extent

of it, there are hundreds of animals and trees and everything else. I do not know how you would rationalize that.

Take two men at the lower level who have both a job and a farm. One fellow is a son of a farmer who has inherited a farm which produced three or four thousand dollars a year. He wants to live differently than that and he goes out and has a job in addition to it. The job produces three or four times the income of the farm. The other fellow has got a job to start with and he happens to like farming and goes out and buys a farm. The results are exactly the same. Is one a hobby farmer and the other a professional farmer because he is the son of a farmer?

MR. GLEAVE: Well, in discussing this we were very well aware of the problems. For example, I discussed this with an Ag. Rep. in our local area who had a farming background but he became an agricultural representative. He wanted to get his finger on the farm again so he bought a piece of land. I told him we were going to make this submission. Well, he said "I hope you don't imagine that interferes with my having this piece of land I have acquired here because I want to do this." I know it is a difficult area. Our chief concern is that the farmer -- let us say anyone who is running the farming operation that that farming operation should be taxed on that operation. It should be taxed as a farming operation. He should be taxed as a farmer.

We are more concerned with this than we are with the hobby end.

We do express here the feeling that they say where a farming operation is clearly a hobby as related to income, then the answer to your question and the question from the research department we would say if this can be clearly established losses from the farm operation should not be allowed to be charged two salaries. I think that is as far as I can go to make a decision on that.

COMMISSIONER WALLS: Also, I think there is quite a bit of justification because I believe the last concensus showed there were 120,000 farmers that were non-commercial farmers earning less than $1200 a year. These people all have some off farming occupation or they couldn't live so they are a pretty big segment of Canadian Agriculture. I felt very much about the hobby farmers as you did till I found out more. I visited one or two of them and found they were supplying services to other agricultural people which was well worthy of support. For instance, Mr. Grant and I visited one chap outside Montreal who is doing cross-breeding between two breeds that were not being crossed by the experimental departmental farms. He was paying a retired professor of animal pathology and was doing some very interesting work that will be of great assistance to agricultural as a whole so it is rather hard to discount some of these hobby farmers who are carrying out that type of work, which otherwise the government might have to pay for.

MR. GLEAVE: With all due respect, I must say that this argument does not impress me a great deal. I think that is clearly the job of experimental farms and those sort of institutions that do the things that need to be done in this area. I may say this, I have noted a concern amongst our farmers. I noticed it in a meeting, one meeting particularly held in the province of Alberta and also in Saskatchewan, talking to a technical man the other day that their concern about the pressures that non-farming occupations are exerted in purchasing farm lands and going into farm operations as a sideline.

Let me make this clear. I am not saying that the taxing power of the government should be used to discourage this. I think that if it is not desirable then there are much better ways of doing it but what I am saying is definitely there are farmers who feel it is putting pressures on resources in terms of land and markets and so on. This is the feeling that exists.

THE CHAIRMAN: Thank you. I see that you would eliminate the maintenance of race horses as a farm occupation. I suppose if the horse breeders would argue they are a credit to the national good by improving the stock of horses. You would deny that.

MR. GLEAVE: Well, let me put it this way. From our standpoint as farmers -- maybe this is because we don't use horses any more. I used to enjoy horses. I used to use them a lot. The only thing that bothered me I never could really learn to

throw a lariat. I don't know why I was so completely blind in this area. We didn't see where horse racing fitted into farming operations. I don't think it would make much difference if it were taken out. I don't think it is significant. We just didn't see where it fitted in.

COMMISSIONER WALLS: Do you think it would make any difference if it were taken out considering what you say before that "Livestock raising or Exhibiting". I would imagine that raising race horses is livestock raising so you take out the maintenance of horses for racing, you would, I think, still be covered under that terminology.

THE CHAIRMAN: I could rephrase that simply by putting in a comma "This shall not include the maintenance of race horses."

MR. GLEAVE: I don't think it is an awfully significant thing really but I say we just don't see where it fitted in. It may come in on the breeding angle as part of a farm sideline.

COMMISSIONER GRANT: "For the purposes of this section, race horses will not be considered livestock".

THE CHAIRMAN: That is a good phrase. Expense deductions. Well, this gets down to farm dug-outs which I saw somewhere or other that they are being used by the farmer in fact as swimming pools and to sail boats.

MR. GLEAVE: They have also been used to drown some people.

THE CHAIRMAN: I understand now that the law is that that you can get a deduction of $300 for the construction of a dug-out, is that correct?

MR. GLEAVE: As depreciation?

THE CHAIRMAN: No, as a write off of the cost in the year when incurred.

COMMISSIONER WALLS: I would like to interject here because the act is thoroughly mixed up on this. First of all $300 in our country we couldn't begin to build a dug-out. We use dug-outs all the time. I couldn't get a dug-out done for less than $1,000 but I believe this is just because during our excavation of water wells can be claimed in the year they are constructed and the purpose of this is exactly the same as a water well. Water towers are depreciable. What is the difference between holding water on the ground or holding it up in the air. Dams, weirs and web equipment and also irrigation ponds. Of course, I don't know why he doesn't call it an irrigation pond in the first place and get the exemption and then you are clear about it.

MR. GLEAVE: He would not be able to honestly say that because the P.F.R.A. assists in making these things and they are classified as dug-outs.

THE CHAIRMAN: Mr. Walls makes a very strong argument indeed. I can remember my father constructing a dug-out with his own tractor at no disearnable cost at all. I would think lots of people would do that.

MR. GLEAVE: It is not usual, sir. Usually the farmers in these cases do hire construction outfits. These dug-outs are generally fairly large size scales. I couldn't give you the measurements but they are not of the type that you use a wheel tractor on. I tried it on a dug-out one time. I almost killed myself. You are on very deep slopes. The usual thing is to hire a construction outfit to build a dug-out. The P.F.R.A. in areas where it operates gives the farmer assistance toward the construction and the balance he handles himself.

COMMISSIONER WALLS: Maybe I could briefly clarify this. I had five acres and I had an engineer put in an estimate and he said it would take the best part of three acres to put the dug-out in and it would have to be 19 feet deep so that shows you have to have heavy construction equipment.

MR. GLEAVE: If you get P.F.R.A. assistance it has to be built to their standard.

THE CHAIRMAN: I think the next thing I have is paragraph 38. The matter of transportation expenses attracted my attention a little bit. I am told that farmers generally speaking get two-thirds of the automobile costs for transportation expenses.

MR. GLEAVE: Yes.

THE CHAIRMAN: Is that not adequate?

MR. GLEAVE: Well, we didn't think they are in case where a farmer -- some of them live some distance from towns and so on. We thought they should be able to charge the entire expense.

THE CHAIRMAN: That is equally true of

city dwellers. One of my partners live 50 miles out of town. I think the law permits him one-half of his expenses because he used his automobile in the ordinary course of his business but it doesn't allow him the full amount and I would think that it is not fair to allow him the total amount. That is living expenses.

MR. GLEAVE: It seemed to us he may take the case, for example, and this happens to a considerable extent in areas where farmers were living in a rural community. We had a fairly radical change from the small school house to a larger school unit. This in some cases meant that there was not adequate rail and bus transportation that the farmer could depend on. He moved to the nearest town and this involves expenses and transportation back and forth. We think under those circumstances or under circumstances where he does live this far away that the full amount should be allowed. It is an expense of his farm to go back and forth.

THE CHAIRMAN: It is up to him as to where he lives. He doesn't to live that distance away.

MR. GLEAVE: Yes.

THE CHAIRMAN: It is not fair to the man who doesn't live that far away.

MR. GLEAVE: You can say it is up to him where he lives. He could have remained on the farm and then he would have had to devise some means of getting his children to the closest point of education, which would be extremely difficult. This, I submit,

really was not a free choice. It was dictated by circumstances and these are the circumstances to which we refer.

THE CHAIRMAN: Well, I get the point. What is the law now in respect of land improvement. I see you say "Land clearing and drainage projects when undertaken by an operating farmer in cultivated areas should be permitted either as a current operating expense --" it is now capitalized and not permitted as a write-off at all.

MR. GLEAVE: Yes, land clearing is capitalized.

COMMISSIONER WALLS: Except if it is done by your own hired man and then you can charge against his wages.

MR. GLEAVE: Yes, you can but I think if the income tax people really want to be technical, they could say no, you can't do that."

COMMISSIONER WALLS: They would have to be technical in an awful lot of cases.

MR. GLEAVE: It would have to be pretty technical I agree. Right now land clearance is capitalized.

COMMISSIONER WALLS: In the United States it is granted as an expense.

MR. GLEAVE: This is our point.

COMMISSIONER MILNE: I have one question to ask you about tree planning. I don't know whether your organization were instrumental in Manitoba, for instance, back in the days of the dreadful dust storms

in having Caragana given free to the farmers just simply to keep their good black soil. On Highway No. 4 you can see miles and miles of these Caragana hedges which were given free to the farmers and I think it certainly must have been a government measure that was necessary to prevent this soil erosion. In paragraph 37 you mention that there is certainly this enduring benefit of tree planting to arrest soil erosion. You suggest that the full cost of planting should be considered a current expense. I wonder if you have given any thought at all to having a proportion instead of the full cost. I know you suggest the full cost but as an alternative, a percentage of the cost and then carry the balance forward.

MR. GLEAVE: Well, the reason we ask for it as a current expense, it is usually not a large one but it is the practice that is growing up unfortunately, I think it is a good thing, farmers are content to plant trees. They set them off the roads for two reasons, one to trap snow and the other to break the wind. The expense is not really a large one in these instances. Usually the local government provides a tree planter, a mechanical thing that will plant trees, and I think in most instances they can get these shrubs for free so the cost is not great and we think it might as well be currently written off and that is it.

THE CHAIRMAN: Tax payment instalments is the next one I have here. I do not see why,

because of the difficulty in filing returns, that farmers should be preferred over the rest of us as to paying their taxes and be able to hand on to their money longer. We all are subject to the nuisance of filing returns and making up instalment returns on it. You put it on the basis that it is a nuisance to farmers to have to pay in advance of the date of filing. I would not have thought that was a very good reason.

MR.GREAVE: Well, I can't think of any other reason. This is the only reason that we can advance. Our simple conclusion is that when the thing falls due to pay the tax due to the government and that is it. Mind you, from our point of view we are talking only about farmers. I cannot say the same thing for other people. That is up to the other people to say what they want done. We are saying as farmers that a farmer is taxable and the government could select the date that they want him to pay that tax and so you pay that on the date period. The instalment thing, we really do not see it. Surely you do as I do. Before the end of December you look at last year's, and you send a cheque to the government.

THE CHAIRMAN: Why? The rest of the country pays on some kind of instalment basis. The employees pay monthly or according to the pay period. I am a professional man. I pay quarterly in advance. Incorporated businesses pays quarterly in advance. Companies pay in advance. Why shouldn't the farmer pay in advance. I don't see why they should be

entitled to keep their money longer than the rest of us.

MR. GLEAVE: Maybe you could do away with it for professional people and businesses also but this is up to them. We see it in the farming sector as being more cumbersome than the simple method of saying to the taxpayer, as of such a date your tax is due, pay it. The government might just as well put a certain percentage on to the taxes and simply collect interest.

To us it just seems more cumbersome; that is the only thing I can say.

THE CHAIRMAN: I think your point is perhaps well taken, if you say that rather than pay tax on these dates, the farmer would be better off to pay it later on and pay interest on it, which I think he is entitled to do right now.

MR. GLEAVE: Let me make this point, Mr. Chairman. I would not say he should pay interest on it at a later date. What I say is that the government knows how much money it wants; it knows how much tax it is going to put on a farmer or anybody else. All right; figure out that amount of money at a steady rate of taxation, and the government will know it is going to get that money, assuming he is going to pay it on a certain date in the year.

THE CHAIRMAN: If he pays on a later date than the rest of us, he should certainly pay interest.

MR. GLEAVE: No, he should not pay interest; he should pay the same as everybody else.

THE CHAIRMAN: I understand your point. I think we understand your section on basic herd establishments.

COMMISSIONER WALLS: Except the statement that the records must go back to 1947. I understand that has now been amended and they must go back to roughly the 1950's. A period of eight to ten years is all they ask.

MR. GLEAVE: That was our point, that a definite period should be set. I do not know if we suggest a certain period here.

There was one point which one of the unions made to me later. I do not know how valid it is becauses I did not have a chance to check it. But they wanted an amendment to the act that would allow mature animals to be brought into the basic herd. Of course, if they were brought in the farmer would have to pay income tax on them. I am not clear on it. My own opinion was that this could already be done, but apparently this particular provincial union did not think so. In any case, if it is not at the present time, I think it is a reasonable request.

COMMISSIONER WALLS: We have had representations from the B.C. Beef Cattle Growers Association in this regard.

MR. GLEAVE: On this same line?

COMMISSIONER WALLS: Yes.

MR. GLEAVE: Then you have it before you adequately.

COMMISSIONER WALLS: Yes.

COMMISSIONER GRANT: I suppose the principle behind this is that if a farmer wants to establish a basic herd from his present livestock he has to be able to convince them that he has papers for these animals?

MR. GLEAVE: You mean registration papers?

COMMISSIONER GRANT: Yes.

MR. GLEAVE: No. Rather, I would say that what he has to convince the income tax department of is that he is entitled to establish a basic herd as a certain size. Might I say it is a capital investment that he has there, and the point I was

making a moment ago was that if he wants to add to this basic herd, instead of buying from outside, if he wants to add his own cattle and hold them in he must report to the income tax people that he is adding this many cattle, and he must pay the income tax on them in that particular year.

COMMISSIONER GRANT: Yes. In the establishment of his basic herd, in the first instance he has two ways of doing that. One is out of his own herd, and the other is going out and buying?

MR. GLEAVE: Yes.

COMMISSIONER GRANT: He has to buy pure bred stock?

MR. GLEAVE: Not necessarily.

COMMISSIONER GRANT: To establish a basic herd, he does not?

MR. GLEAVE: Not necessarily, no.

THE CHAIRMAN: The next section is farm records and filing procedures. You suggest that the tax department should produce a book. That might be a valuable suggestion.

COMMISSIONER WALLS: I am interested in this. What do you really find wrong in the farmers' and fishermen's guide at the present time. I think they encompass as much as can be encompassed in it, and it is certainly more than is given to other taxpayers; and it is amended each year. Do you not think that is a very good service?

MR. GLEAVE: Perhaps Mr. Bennett would hand this book to you.

(Farm Record Book of the Saskatchewan Farmers Union handed to the Commission)

Apparently, Mr. Walls, it has not been sufficient, because over the years in Saskatchewan, for example, we have developed this particular book. It was done first by our income tax service, to keep our farmers in the groove, you might say, so that there would be a steady pattern, which would make it easier for filing. They found that it worked very well. In fact, our income tax consultant told me off the record that one of the income tax offices was using it for a demonstrator only. They had cut out the Farmers' Union insignia. But something of this nature is what is required.

I would say that what they have told me also in regard to this is that for the very large farmer this very simple book would not be quite adequate; but it did fit very well into the scheme of most of the people who are concerned with filing. It was our thinking that something along these lines might be developed, in consultation perhaps with some of our officers, just as a convenience.

THE CHAIRMAN: If you are doing this, why should anybody else do it? Why impose it on the government?

MR. GLEAVE: Well, we only reach so many farmers. This is the only answer.

THE CHAIRMAN: In your next paragraph, No. 47, you suggest that consideration should be given to raising the "once in a lifetime" gift limit from $10,000 to $20,000. Then you say:

"The exemptions for the individual taxpayer donor should be raised from $4,000 to $10,000 as an annual gift free of gift tax in any one year."

That will be considered. Then you deal with classes of businessmen. I do not think there is anything in that section that we need to question you about.

Then you suggest that farm consumed produce might be omitted from farm income. I assume this is generally a rather small amount?

MR. GLEAVE: Yes. This is our point, that it is not a large amount, and that what the government is interested in is the farmer's cash income.

THE CHAIRMAN: I would not think one would wish to change the law if it is a rather small amount.

MR. GLEAVE: We recommend that the practice of taking the value of farm-consumed produce into farm income be discontinued.

COMMISSIONER WALLS: I suppose you are representing predominantly wheat farmers, and they do not have very much farm produce that is consumable, do they?

MR. GLEAVE: I think that in Saskatchewan now about two-thirds of them are not solely wheat farmers.

COMMISSIONER WALLS: So it would be a bigger factor?

MR. GLEAVE: We do find it is a fair factor. What the income tax people is take a rough yardstick and say to the farmer, "How much have you

used?", and they arrive at a sort of agreement and that goes in.

THE CHAIRMAN: There is nothing in paragraph 50 that I want to ask questions on. Then paragraph 51 deals with farmers allowances granted. We are in agreement with that. The next paragraph is concerned with depreciation on farm lands. I think we can go down to sales tax, can we not?

In paragraph 57, you recommend that the exemptions be continued in respect of farm machinery and you put forward some arguments in favour of that.

COMMISSIONER WALLS: We are in a rather difficult position here, because we must recognize that we are getting exactly the same argument from manufacturing concerns, which are now taxable on the apparatus and machinery of production and who also have to compete in the export market. Many of them, of course, have appeared before us and said, "If this is going to affect our machinery of production, why should it not be put into effect with regard to all machinery of production?"

The very arguments that you use have been used against this contention. Have you anything you can give us to strengthen the farmers' opinion on this?

MR. GLEAVE: The main argument I can use is the one that is stated here, that we are in an intensely competitive field, as you know. Our products go on to the world's markets in competition with other groups, and a small increase here, with the margin that we have, could render us, shall we say, unable to

meet this competition.

This is the argument which we advance for keeping it. I think we might also take note of the fact that some provincial governments -- at least, Saskatchewan -- make a similar exemption in their sales tax, in recognition of this same thing. This, I think, is essential if we are going to stay in the business and have an agricultural industry that can survive and get along.

THE CHAIRMAN: The next paragraph deals with personnel exemptions. You suggest a pretty substantial list in those, from $1,000 to $1,500 for a single person, and from $2,000 to $3,000 for a married person. While I have not computed what the cost of that would be in the loss of revenue to the government, it would be immense.

Would you have any idea what that might amount to?

MR. GLEAVE: Not at all. This is in here because it has been coming to us continually through our provincial conventions. This is the attitude they have taken. This is what they wish us to express.

THE CHAIRMAN: Have they any thoughts as to where the revenue should be recouped?

MR. GLEAVE: No.

THE CHAIRMAN: Thank you.

The next paragraph deals with estate taxes. You suggest that the $60,000 basic exemption should be lifted to $100,000. You are not alone in that thought. We have heard that from several people coming before us. You base it on the fact that the value of

farms is now up to the point where $60,000 does not take care of most farms, I think, and you suggest that therefore it should be increased.

COMMISSIONER WALLS: The only thing is that if the census figures are correct, 88 per cent of farms -- this is taken from the 1961 census -- have a capital value of under $50,000, and only two per cent of farms have a capital value of $100,000. Anyway, this is a matter that is under consideration because it has been put forward to us by many other people.

THE CHAIRMAN: The next section deals with cooperative taxation. There is just one point I would like to deal with. There is one sentence that struck me with some force. As you may know, we have had a great deal of representation in the matter of cooperatives on both sides of this issue. On page 15 you point out:

> "Present taxation procedures have allowed cooperative enterprises such as Federated Cooperatives Limited to expand their wholesale business and to go into production in some fields such as chemicals, which is an advantage to the farmer since again it offers an alternative supply and gives him an effective yardstick as to actual cost of production of those things which he uses to produce agricultural products."

You are of the opinion that the growth of Federated Cooperatives Limited is to some extent due to favourable taxation?

MR. GLEAVE: Partly this, and partly to the

willingness of farm people and other people to leave some of their savings in to allow this expansion, yes.

THE CHAIRMAN: "Yes" is your answer?

MR. GLEAVE: Yes.

THE CHAIRMAN: The leaving of their savings in is generally suggested to be eased by taxation, and I suppose that is true.

MR. GLEAVE: I would think that this is so.

THE CHAIRMAN: I have nothing further on cooperatives. What you say about cooperatives has been said to us quite often.

MR. GLEAVE: Yes. I may say that as a farmers' union, while we have no financial interest in cooperatives, nonetheless our farm people consider and know that they get considerable advantages from cooperatives and we are concerned that nothing be done that would render them less effective on our behalf than they are. That is our position.

THE CHAIRMAN: Thank you. We are interested in this matter of education costs, even though it may be beyond the job we have undertaken here. We are glad to have a summary of what was put before the Royal Commission on Taxation in the province of Saskatchewan. I thought this was quite interesting. You make the case very clearly that a large share -- in fact, the largest share -- of the education costs of that province are being borne by the farmers rather than the urban dwellers.

I do not propose to try and test the figures you have put before us. That is the job of

the other Royal Commission, not ours, I think.

MR. GLEAVE: Yes. I think the statistics there will stand examination.

THE CHAIRMAN: I am sure they will.

MR. GLEAVE: I may say that this is a general feeling in our unions. We simply made an exerpt from the statement that was put before the Royal Commission in Saskatchewan of what we believe is the position taken by the five unions.

THE CHAIRMAN: I thought that some of the figures in your tables were quite interesting. I had not seen them set forth in this way before. You have, of course, covered the whole country in these figures. You have shown us many things. I noticed particularly that there is a great disparity as between the different provinces in the proportion of farmers who pay income taxes. I was curious as to why this appears. I suppose it must reflect the prosperity of the farmers. But the swing is dramatic, is it not?

MR. GLEAVE: Yes, I would say it is. I am not in a position to comment on them because we have no information in this field, of course. However, we did ask, or I should say I asked, the people who prepared these figures to put them before the Commission for your information, because it would be useful for a Commission such as yours to have put before you the tax position of the farmers in the various provinces and the total taxes which they are paying.

THE CHAIRMAN: Then thank you very much indeed, Mr. Gleave. I have no more questions. This has been very helpful to us indeed. It is nice of you to come and subject yourself to our questions, which I think you have answered very well. We will certainly take into consideration all that you have said and put before us. Our job is very far from done. We have a huge mass of material to digest from here on in. As I say, due weight will be given to this. In fact, I can certainly see some of your suggestions, which to my way of thinking have considerable merit, may be useful. I will not say that all have merit, in my opinion, but some have.

MR. GLEAVE: That would be too much to hope for, sir!

THE CHAIRMAN: Well, thank you very much indeed. We will now stand over until 2:15 this afternoon.

--- Luncheon recess.

---Upon resuming at 2:30 o'clock p.m.

THE SECRETARY: Mr. Chairman and Commissioners. This afternoon we have a presentation by Mr. Alexander K.G. Reid of Vancouver. This brief and the supplementary brief are private submissions of Mr. Reid which I now enter into the record as Exhibit No. 315 and 316.

---EXHIBIT NO. 315: Brief submitted by Mr. Alexander K.G. Reid

---EXHIBIT NO. 316: Supplementary brief submitted by Mr. Alexander K.G. Reid

Mr. Reid will say a few words, Mr. Chairman, before questioning.

THE CHAIRMAN: Thank you, Mr. Reid. Glad to see you. Thank you very much for what you put in to us. It has provided us with good reading. We will certainly have a few questions to put to you but before doing so do I gather you would like to say a few words.

MR. REID: Mr. Chairman, I feel I have said practically all I have to say in this brief and my presentation but I am prepared, of course, to elaborate on any point which you may feel requires such. I might add the submission is made in the philosophical sense that I feel that Canada has and is losing a great proportion of her productive elements, her people and that something must be done to stem this tide and it seems to me that one of the measures most easily implemented would be to produce a carrot that would attract people to stay in the country and perhaps

attract others who are capable and can contribute to our country's growth to come to Canada. In other words, to make Canada the star in the western world of opportunity. I will now make myself available for all questions.

THE CHAIRMAN: We are of course tremendously concerned with the loss of our human resources. I have been impressed by the fact, I think, the educational standards of our immigrants are perhaps higher than the educational standards of our emigrants, broadly stated. Certainly there are exceptions to the reverse but I have heard that we are losing a lot of our educated people, but I have seen not much evidence on that score. Do you know of any? Have you any facts to support the loss of individuals to other countries?

MR. REID: Under Exhibit A of this submission under the heading "Loss: Skills, blood and brains -- wanted: Tools to turn the tide". We have quoted from reports to the effect that we are losing basically in our emigation 23.5 per cent of them who are highly educated and skilled individuals the effect upon the average of the population of the whole of Canada would seem to be about 14.9 per cent so it appears there is a dilution in our emigration. It is true we do have immigration of highly capable people, skilled people and educated people but then that is something which should be expected on balance we should not be losing people. We should be attracting people in the hordes. Canada has so much to offer, in freedom of effort and in very vast natural resourses. We have much to offer. Unfortunately the people are not accepting our offer in

the quality we should be receiving and there must be a reason for it.

THE CHAIRMAN: You point out that last year about 5,500 professional people left Canada plus another 1,000 belonging to the managerial group. That is 6,500 out of, I suppose, a total immigration of about ten times. Would that be right?

MR. REID: Forty-seven thousand left our country last year.

THE CHAIRMAN: Of course, the interesting point to us would be to what extent this appears to be due to taxation. There is very little evidence on that.

MR. REID: Yes, I agree. Taxation is not necessarily the cause directly because they move to countries who have similar taxation. The opportunities exist in these other countries. I think I am speaking particularly of the United States but these economies were built during a period when taxation was a great deal lower than it is today. In fact, it was almost non-existent. These countries -- I will speak particularly of the United States -- grew to stature greater than Canada prior to taxation. The momentum of the economy was dynamic and not stifled by taxation. Canada, I suggest, was stifled in its early adolescence and has really not had an opportunity of developing except by encouraging foreign wealth to come in and exploit our resources.

The nature of Canada or the nature of the Canadian people is such that they are not accustomed to being entrepreneurs as a nation. Of course, we find

many entrepreneurs in the country but on a per capita basis I think you will find they are much fewer for our resources than you find across the border. The result is the traditional background -- substantially Scotch. I can say Sctoch because that is my background, very careful people and they were brought up in the nineteenth century when debt securities were a sound investment to make and this feeling has continued in Canada to the detriment of our permanent financing through equities.

THE CHAIRMAN: I think we will come to the reasons for that as we move on. We will discuss it further. I think it will be better if we probably stuck to the order of your submission and explore the philosophy which you speak of right now. You approach taxation on the basis that there should be three types of persons taxed, the individual, the business entity, andthe conduit, I think.

MR. REID: Yes. Personal entity, business entity and conduit entity.

THE CHAIRMAN: Many people put to us that business entity should not itself be taxed, that the owners of it should be taxed. It is in fact a conduit through which profits move to the owners, and that in fact one cannot tax an inanimate being, one can only tax a real living person. If one taxes other than that, it is only taxing on account of the living person. You do not subscribe to that I do not think, or you would not be suggesting the 50 per cent tax on a business entity.

MR. REID: Mr. Chairman, that premise, I would say would be very sound if we could start from scratch today but unfortunately we find ourselves substantially tenants in our own country. If we should regard a legal entity, a corporation, as simply a conduit in the same sense as an investment company, then we would find all sorts of strange anomolies developing as a result of this change of tax treatments to corporations.

Almost immediately you would have to take measures to offset the advantages that might accrue to a very substantial foreign ownership. Even though the net result might be the same the change would seem to be moving against foreign ownership. I think it would be almost impossible to make any move except where it was outright beneficial to alter the concept of taxation by taxing corporations because of them being conduits and changing it simply to apply to owned corporations, shareholders or proprietors. I feel we have put ourselves in the position of not owning the majority of our corporations. We have to live with this and adjust to the best way possible without alterning the status quo of the foreign owners while at the same time being able to award the individuals who produce to make these corporations successful.

At the present time executives of the corporations are very hard pressed in the same way the professional is. Owners of business, on the other hand, can adjust their tax positions to quite a satisfactory degree. Now, in my own instance, I have no complaint about the present taxation as it affects

me. I might say I am covered in paragraph 143.

THE CHAIRMAN: You are incorporated.

MR. REID: I have a corporation that is owned 51 per cent by myself and 49 per cent by my wife. I can split income. I can move income of the corporation to myself as a salary and to the extent that my tax rate comes to a point where it will be more beneficial to leave it in the corporation, I can leave it in the corporation. At some future year I can decide to take no income from the corporation but to pay dividends and attract substantially no tax.

I am not complaining about my position. I think that taxes should be applied to all individuals equally and to allow those individuals to apply their efforts and their talents to earn and form capital to the best advantage. I do not think one legal entity should have an advantage over another one simply for legal reasons.

That is one of the premises in my submission. I feel that by altering the approach that we can eliminate some of this injustice that did exist and it is not injustice to myself. It is injustice against my neighbour who happens to be a doctor and injustice against certain business executives I know that are not the owners of a business but work for the corporation and produce.

THE CHAIRMAN: I see your points. Some years ago I recognized if I incorporated myself I would pay less taxes. I proceeded to tell the government I wished to do so. I was informed that I would be

prosecuted if I did. I was never very sure that there were any legal grounds but Iwasn't going to fight them. Certainly if I had been incorporated before I would have saved myself a certain amount of money because of the lack of appropriate balance between the two forms of taxation.

Mind you, we hear more about the effects of double taxes on corporate income as being a discrimination against the owners of the corporations. It has been pointed out they are taxed twice and have to pay more taxes than does the professional man or wage earner. Under certain circumstances that may be true but under other circumstances it is not true, as you state here. I am not at all sure that there is notsome justification for a different method of tax because of the legal entity on these grounds. You do not agree with that but the fact that corporations are in a position of being able to hold up the distribution of its income which the individual or a partnership cannot do -- that income must be taxed as earnings -- the corporation has got the right to defer taxation and that right is a valuable one.

MR. REID: In a sense, let us say, the small corporation owned by a man and his immediate family is very similar to a retirement savings plan without the limitation of 10 per cent. It is a deferrment of income. In fact, it is more advantageous because it can be deferred beyond his 71st birthday.

THE CHAIRMAN: Provided it is not a personal corporation.

MR. REID: Yes.

THE CHAIRMAN: I would like to take a close look at how you work out your personal income tax. You have worked out a scheme of taxation. I was not able to quite follow how you got at it. I think it must be my fault. You have got a schedule at the back here.

MR. REID: Correct.

THE CHAIRMAN: And they show that at some tax rate your proposed tax is higher but generally it is lower, generally it is quite a bit lower. Table 2 is what I was looking at and the present tax on $3,100.00 under the conditions that you have set forth is $140.00, 4½ per cent. Where does the $155.00 come from?

MR. REID: This is based on a flat rate of 5 per cent of all income received from the first dollar. There is a basic floor of 5 per cent. Then there are suggested personal deductions. In this case I have suggested $3,100.00 for a married individual as against $2,100.00 as it now exists today. This again is just a figure I have taken. It seems to work out.

THE CHAIRMAN: For a married man as against $2,000.00.

MR. REID: As against $2,100.00 using his standard deductions for medical and charitable donations so I have increased that by $1,000.00 simply because it works out. Then the basic tax of 5 per cent would apply from the first dollar of income. Then $3,100.00 in the case of a married man without children would apply as a deduction against the full income and after

personal deductions. From there on to $50,000.00 would attract a further 10 per cent tax making a combined tax of 15 per cent. This is a proportional type of tax. In fact it is a three stage proportional tax, five per cent, 15 per cent and then above the $50,000.00 the tax is 50 per cent making his proportional tax from there on 65 per cent.

THE CHAIRMAN: These are pretty big steps, are they not?

MR. REID: Yes, they are. Well, the step above 50 is a big step. I might add it is political. You see that it does not disturb very substantially the tax rate applicable today. Let us take $92,000.00 level of income where the income today would be 49 per cent on his total income. He would pay 35.9 per cent on this proposed scale. The reason that it shows lower is because the 15 per cent proportional tax on the first $50,000.00 is so much lower. The purpose there is to give the young executive, the young professional, the young businessman, employee, tradesman, an opportunity to work hard and to have a work capital and that is what we lack today. I am very aware of this in discussing this matter with my son and his contemporaries because I know what it does. I will give you an example. My son is quite an entrepreneur in heart and he and some other chaps of his own age decided they would get control of a company so they borrowed some money from the bank and they proceeded to acquire the shares of this small processing company. The management was poor incidentally, and they felt

that by getting control of the company they could remove the manager and put in brighter people in and make a successful company. They didn't do their homework well enough and they did not succeed in getting control of the company with the result that the shares that they had bought had less value than what they paid for them. Now, he lost close to $10,000.00 for his part of the deal. He is earning quite a substantial income today but because it is all earned income in his hands, salary and commissions, his tax rate is very substantial, and it is going to take him several years to pay off this debt. It probably has discouraged him a little bit. I don't think it will in the long run but look at those years that are lost! This is the shocking part of it, the years that are lost. If his loss could be recouped fairly rapidly then he could try again. It might be until he is thirty before he will make another stab at this unless something unforeseen should happen, a windfall of some sort.

This is just one small example. There are many different examples that can be seen today that we do not consider because it is a condition that exists but if we could make opportunities available for these young people to apply their initiative and their ability to form capital out of income and to become investors in our country I think that the ills we see today would not be as pronounced as they are today.

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We would find that perhaps we were not so much tenants in that way and that we might be more the earners of our country.

THE CHAIRMAN: In order to do that should not the abatement that you speak of be further down the line than you propose? I have been contrasting your two columns here, and I note that at $4,100.00 the rate which you propose is about 3 per cent less than the present taxes, $305.00 as against $310.00. Then I go up, and the $455.00 as against $510.00 is about 10 per cent. On $6,100.00 the reduction is about 15 per cent.

I would have thought it is probably $10,000.00 down when you are thinking about the use of the country being able to save more of their earnings. When you get up to $10,000.00 the reduction in your plan as against the present rates is about 40 per cent. It really drops at $17,000.00, when it comes down to about half what it now is. At $27,000.00 you reduce it from $8,660.00 to $3,755.00, which is about a 50 per cent cut, and so on. Your proposal really produces major reductions in the rates between $25,000.00 and $$70,000.00 or in that area.

MR. REID: This is correct, Mr. Chairman. This is the first measure. To begin with, we are faced with producing as much as fiscal revenue today, under any proposal, as we need today. We cannot hope to get a reduction in total fiscal revenue. We have to meet that fiscal revenue unless measures are found to economize, but I do not expect that will be as easily implemented as adjusting the measures of collection.

But the first stage is to create the incentive for people who are ready and able to take action today. The next step -- and you will notice this further in my submission -- as time progresses is to keep raising the personal deductions so that the lower income brackets become non-taxpayers, because I feel it is very desirable that the low income brackets do not pay any direct tax; that they should be substantially exempt from income tax. Then ultimately to remove sales taxes, so that the take-home pay of the workers, the people who may never find themselves with an opportunity of earning much income, will mean that these people will be able to get a good return for their services and be able to seel their services at a competitive rate to other countries.

In other words, the cost of producing our Canadian products will be kept lower by virtue of the fact that the take-home pay of the workers will be higher because of low taxation. This will, of course, require a buoyant economy. You cannot start cutting taxes out at the bottom, because that is your main source of revenue.

At the present time, if you reduce the income tax by 1 per cent in regard to a man who is earning $3,000.00, it really does not accomplish anything for the economy; it does not give the spur to the economy that a substantial reduction in the heavily progressive tax in the $10,000.00 to $50,000.00 brackets would. These people at the present time are spending much of their efforts in finding ways of avoiding tax. If they

have a straight forward taxing system they say, "This is a fair tax. We just forget about our tax problem. Let us get to work and produce more income". In the process of producing more income, they produce more efficiently for their companies and more efficiently for our country.

This is the theory. How naive it might be, I do not know; but I feel this is the way and I think I should express it.

THE CHAIRMAN: It certainly bears some looking at. I think it is a worthy end to try and remove the lower income people from taxation, providing that one does not feel that they would be escaping their normal obligations. It is a nice point as to when taxation should start. Afterall, what is government expenditure? It is expenditure on our collective services, and some of the services are just as highly essential to the individual as is food, clothing and shelter. There is no way of preventing one spending money on food, clothing and shelter.

Should he be totally left out of taxation? Should that burden be passed on to others, even though these services are essential to him? Where should you eliminate tax on them? I think the best one can do is to find a compromise somewhere. No country, so far as I know, has achieved their deductions on a basis with regard to which they can say, "This is subsistance" or "This is a poverty level".

MR. REID: Mr. Chairman, if in the future it is possible to remove taxation from the low income groups,

it would seem to me that this in effect reduces our production costs to the extent that the individual receives his full income in the form of payment without a further responsibility to pay tax.

I am thinking in terms of exports. Domestically it does not matter too much; but in terms of exports, labour is a big factor in most industries. In some industries, it is not a big factor; but I think in most industries I would be right in saying that labour is a predominant cost.

If the wages to labour can be fair and free of tax, it must reflect in a lower cost of doing business. The result would be that production would increase in turn, increasing profits, out of which, as I term it, a royalty would be paid to the country. So in effect labour is receiving a larger wage indirectly through social benefits, which are paid for out of his contribution to the production of the country. But it does not come in the form of a cost; it comes in the form of a division of realized profits.

THE CHAIRMAN: What is more, the domestic market would be increased, which would be a very valuable contribution to our economy.

MR. REID: Yes.

THE CHAIRMAN: I think we must start off by recognizing that all taxation is a burden, and the question is, how is it going to be spread?

MR. REID: That is correct, Mr. Chairman. In the most comfortable form.

THE CHAIRMAN: That is right; in the least

damaging form.

MR. REID: In the least damaging form.

THE CHAIRMAN: Taxation itself is not something which gives the economy a lift. It is a depressant. Then there is the other side of the taxation question; the expenditure of the monies raised in taxation. That may be just as important, but that is not what we are concerned about; we are concerned about taxation and I think our job is to find out just how to arrange it so it will have the least damaging economic effect.

MR. REID: I find myself in full agreement with you, Mr. Chairman.

THE CHAIRMAN: Certainly when one puts it on to wage earners it dampens their ability to spend money. It raises the costs of corporations in some ways, although you say no. We will come to that in a minute. When you put it on professional people, shareholders, and so on, it certainly diminishes their ability to invest.

We have to select the best method out of all these bad choices. I do not think there is any method we can find that will not have some ill effects.

Your priorities, I think, for the diminution of tax are, first of all, the middle brackets, so as to increase investment; secondly, the lower brackets, to reduce manufacturing costs, and then, I suppose from what you have said, sales tax perhaps?

MR. REID: That is correct, Mr. Chairman.

THE CHAIRMAN: Would that be about the way that you rate the priorities?

MR. REID: In about that order, Mr. Chairman. There is one point in mentioning the professionals dilemma. I think it has come to the notice of most people today, certainly in British Columbia, that the medical profession has required an increase in fee structure. Of course, this has brought the labour unions up in arms. They could not see where the professionals needed an increase, because they were the highest income group in the country, at least according to statistics. I think we know differently.

The unfortunate part is that the fee produces less and less take-home pay for the medical profession, and for any profession, as it increases. So in order to retain, let us say, $1.00, they have to increase their fees $2.00. Later on, as they get into a higher bracket, they will have to increase their fees $3.00 to retain $1.00.

This is one of the reasons why I propose that the professions, even though they are denied incorporation, should havethe advantage of what I term a business entity and should be taxed in the same manner as a corporation or a partnership or a private proprietor; that anybody who is actively in business through a profession or commercial activity would be rated the same way for tax purposes; that activity would determine tax, rather than legal entity.

COMMISSIONER GRANT: The medical practitioner, Mr. Reid, who is going to get a higher fee for his services -- that is, under a pre-paid medical system -- is not in any different position, is he, except in so

far as the percentage of tax that he pays, to the salaried man or to the labour unionist who acts under a job classification labour contract? It is just the amount of tax that he pays in the higher bracket that you are stressing?

MR. REID: That is correct, Mr. Grant.

THE CHAIRMAN: The diminishing net return to him?

MR. REID: The diminishing net return to him. But in a sense he operates a business. Of course, tied in with this, Mr. Grant, is the proposed amelioration of the $10,000.00 to $50,000.00 rates, because this would cover the executive, labour, skilled and unskilled, and anybody in an employed capacity. So that you would in a sense have a dual role for a businessman, incorporated or unincorporated, or profession -- that he would have his professional business. Then he would be an employee of that professional business, in the same sense that the owner of a corporation today can employ himself. That you would have two approaches to taxation. The business entity would be in business for profits, and "profits" means anything in the way of a figure on the black side of the ledger; that is, from capital gains, from revenue, from services or trading commodities.

In the business entity the tax would be at a 50 per cent rate from the first dollar. But you could see what would happen, that he would drain that company until he reached the point of 65 per cent on a personal basis, and then he would leave the balance in the

company. This allows a professional, an unincorporated business, to do what is possible under a corporate structure today owned by a close family group, shall we say, husband and wife.

COMMISSIONER GRANT: I daresay that the only thing that prevents the professional man from incorporating today is his own society's act under which he is licensed to practice, which is a provincial matter and not a federal matter?

MR. REID: Yes.

THE CHAIRMAN: Professional people have, of course, found a way to circumvent that, you may or may not know. I know of one or two firms of chartered accountants which you would never know were incorporated because they assume full personal liability for their acts; the incorporation does not interfere with that. The corporation is really a tax entity behind the facade of the partnership. I say "facade" because it is still a full partnership, because the people in the partnership still assume full liability.

MR. REID: This is one of those circumventions, Mr. Chairman, that could be avoided. Today our tax laws are difficult. They have been put together over many decades and probably the sophisticate can find ways and means of arranging his affairs so as to attract minimum taxation; but most people are not too aware of these things. It results in inequity. It is available to everybody, but not everybody knows what measures can be taken.

It would seem to be much more sensible, if this

is possible, to work right out in the open and say, "Well, this is the law. This applies to everybody, whether you are aware of it or not". Today you have to spend a lot of time studying what can be done and what cannot be done, and also there is the risk of an alteration affecting your long term plans.

THE CHAIRMAN: An alternative has been put to us which I think accomplishes the same thing that you seek and is much more simple under our existing system. That is, to eliminate the lower rate of corporation tax, move into the single rate at the higher level, and then to permit certain types of corporations to be taxed as if they were partnerships. There is a precedent for this in other countries.

At the higher rate of corporation tax I think there would be little benefit to the professional man becoming incorporated. In fact, he might be better off than the incorporated man. Therefore the straightening out would go in the other direction, the direction of which you speak. But nevertheless it becomes a parity either way. Do you follow me?

MR. REID: I do not think I do, Mr. Chairman.

THE CHAIRMAN: First of all, we have one rate of corporation tax. Then we allow certain small companies or private companies to in fact elect to be taxed as though they were partnerships or sole traders. So that they can put themselves on the same level as the others.

If corporations were only taxed at the higher rate, the advantage would be to move in the direction

of being taxed as though they were unincorporated, not the direction that you put it at, because the reason a company has a favourable rate of tax, on your thesis, is, I think, because of the lower rate of tax on the lower earnings?

MR. REID: Yes.

THE CHAIRMAN: If you eliminated that, it would not be so.

MR. REID: This is unquestionably a factor. But there is another point also, again reversing it to my suggestion. We will take the professional again, a medical man who has established his practice and then he decides to specialize.

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Then he has a further course to go through at quite a bit of expense to himself and loss of earnings. This is a capital investment in future earning capacity, yet he is not allowed to deduct this expense as a business expense. I think this should be allowed, because if a business executive is sent down to Harvard school of business to equip himself for a senior executive position, that is an expense which is deductible in the business. Am I not right on that?

Therefore, my suggestion is mainly to bring equal opportunity to everybody, regardless of their profession or trade, and without his having to become a tax accountant in his spare time.

THE CHAIRMAN: We have had representations to this effect before, that some means should be found for spreading higher education costs over a man's earning period. It is hard really to see how this could be achieved. First of all, one has to decide what are those particular education costs. Perhaps what you say is quite right and that they should be written off in some way.

One opens up a tremendous area here. For example, why should one discriminate in the case of technical or diploma courses as against degree courses, and so on? It may make it so difficult that the system could not stand up to it, I do not know. There is undoubtedly a lot in what you say, Mr. Reid.

COMMISSIONER GRANT: Just before leaving the personal entity, Mr. Chairman, I should just like to discuss with Mr. Reid the effects that this would have

on the low income earner who is today exempt from income tax. He would immediately pay tax on his earnings of 5 per cent. While you are prepared to give up between 9 and 10 per cent, based on the 1960 total personal income tax take, on the ground that you will make it up on the business entity and sales, yet I cannot help but feel that to adopt your whole concept of taxation as set forth in your brief would create a terrific impact on the low wage earner, notwithstanding the fact that you are increasing the exemption by $1,100.00 to a married couple. Would you express yourself on that?

MR. REID: As I qualified my remarks in the opening part of my submission, these are, of course prepared as a basis for thought. I do not purport to be an expert statistically on income tax. It is simply to get the idea over in reallocating the tax burden to allow greater production to our economy.

In the instance of the very low income bracket there is a flat basis of five per cent. You will notice too that accompanying this is the suggestion that family allowances be exempt and that old age security payments be exempt from income tax. Perhaps some alteration would be required in the personal deductions as well. So that the low income individual would not be hurt in any way, at worst being left status quo. It is not the intent to load the low income earner with even a percentage of tax, but to hold the line there until we get our economy moving, giving incentives to the people already in a position to produce, and then to take a progressive step to lift

the burden from the very low income brackets. This would have to come second because we need the impetus.

THE CHAIRMAN: We are told that this would add one and a half million people to the tax roll and $9 million in new revenue.

COMMISSIONER GRANT: Notwithstanding that the low income earner is not now subject to tax, there are many wage earners in the country who, due to the exemptions -- that is, wage earners with families of 5 or 6, and so on, who are earning around $3,500.00, and so on, who are not subject to tax at all -- suddenly they will be confronted with a tax of $150.00. They will be told that they had accepted the family allowance and that they would not pay tax on that, but they will say that they could not care less; that they may not pay tax on that allowance, but they did not pay any tax on family allowance before. There is where your proposal does affect a vast number of the citizens of this country. That is why I am asking you whether or not you have any further explanation for your stand than appears in your brief.

MR. REID: Mr. Grant, you have a point, there is no question about that. Perhaps one of the analysts would come up with an accounting suggestion, perhaps something like the elimination of the first $1,000.00 or $1500.00 or $2,000.00 of income from the five per cent. But the revenue would have to be raised by sales tax or some other measure.

I wonder whether a more buoyant economy would not produce improvement within a year or two of incomes

generally in the lower income brackets, except those who are incapable of working.

THE CHAIRMAN: That is something which, of course, we can take a look at and try to assimiliate in our economy. Shall we move on to depreciation allowances? I find the greatest difficulty in seeing much merit in this proposal, which we have had several times before, but I may be overlooking something. You say that a free depreciation be permitted, that is up to 100 per cent.

MR. REID: Yes.

THE CHAIRMAN: Depreciation is essentially a measure of the erosion through wear and tear or obsolescence of fixed assets. It is something to measure income. It is not a tax concession as I see it, but something to measure income. If it is something to measure income, the best measurement of it is achieved when taxes are not involved. That is when the management of a company is reporting on its operations to the owners of the company. They are the figures which we find in financial statements, particularly in those statement which do not use capital cost allowances for the measurement of income.

When we find that, we invariably, I think, find that the capital cost allowance has been greater than has the depreciation claimed. This is, to some extent, because the system has not fully matured. The lines may, of course, in most companies at some time or other cross, but up to now that has been the case. To that extent the existing system has been generous

up to now.

Your proposal is to increase the generosity, because I think it can only be generosity. I think one must call it that. Once it goes beyond the measurement of income it is a concession of generous treatment.

Now, you say that this does not cost very much because it catches up at some time. I think the cost to the government is enormous, and that the benefits are also enormous. There is a vast amount of money which, on the best measurement of income, would have passed to the government, which because there was not the best measurement of income stays with industry, and there is no interest charged.

As you know, money is valuable if you are in business, and it has a price. Certainly when the government is out that money it has to pay interest in respect of other money. Recently I was in your province, and I was concerned with the affairs of the B.C. Electric. They had $44 million,being the balance of the reserve to set forth the difference between taxes paid on capital cost allowances and on depreciation. If you take that kind of money and multiply it by the number of companies all over the country, it adds up to a huge sum which annually the government loses out on.

MR. REID: I do not think I suggested that there was no difference in cost, because I should be acutely aware of the value of compound interest. However, we do need a shot in the arm to our economy.

We need incentives to improve our plant and equipment, and if there is a chance to recapture the investment at an early date so as to make cash available again, I think this measure could be most helpful to us, even if it were a temporary measure for two or three years, so as to spur capital investment.

From a practical standpoint on the question whether many companies would take advantage of the full 100 per cent unless it applied it to the needs of their business, let us take, for example, the case of a bank with a building which is being amortized over 40 years. These are substantial investments. I doubt very much whether a corporation of that type would write off the building at the rate of 100 per cent, because it would distort their earnings flow and distort ---

THE CHAIRMAN: Well, would you take the case of a manufacturing company rather than a bank, which is essentially a service business.

MR. REID: Yes, that is correct. Let us take the case of a manufacturer who has a substantial amount of his capital in production equipment and would probably be a person who would use the heavy write-off to the extreme.

THE CHAIRMAN: If I were a shareholder and the directors did not eliminate profits for tax purposes when they were able to do so, I would expect to find a new board of directors there. That is their job, to make the lowest possible profits for tax purposes, and if they did not take advantage of

that they should not be there. There is no reason why they should not, where they can, eliminate profits for tax purposes. They report the profits and they set up reserves to make up the difference. But for tax purposes they should not be paying taxes when the law does not require them to.

MR. REID: Other considerations have to be taken into account in reducing profits to the extent where established dividends are in jeopardy.

THE CHAIRMAN: But this does not affect that. This is only capital cost allowances to which you are directing your attention. It is not changing the depreciation for corporate purposes at all. This would not affect the reported profits.

MR. REID: One thing I omitted here which I should have put in was that depreciation of equipment for tax purposes would have to be carried in the balance sheet of the corporation. You cannot have two sets of books, one for ---

THE CHAIRMAN: We do now.

MR. REID: Yes, but that is something which I omitted.

THE CHAIRMAN: Then if you are going to describe that I will accept what you say as a fair statement. To the extent that the companies are prepared to take 100 per cent and report it, and so on, that is your recommendation?

MR. REID: Yes, that is my recommendation.

THE CHAIRMAN: You will have the whole accounting profession down your neck immediately, of

course. If you remember, some years ago this was the practice, and one of the largest Canadian companies, Aluminum I think it was, wrote off the maximum permitted for tax purposes. Therefore they had to put a footnote at the bottom of the income account so as to explain what was their practice, because otherwise the income account was useless. Do you recall that?

MR. REID: Yes.

THE CHAIRMAN: I think you have a return to that position.

MR. REID: Yes. But if the balance sheet reflects the actual write-off, one balance sheet for the tax assessor and for the shareholders, then you know exactly where you stand as a company.

THE CHAIRMAN: I think that is a most important matter. Whether or not one goes to 100 per cent, should tax write-offs be restricted to the amount in the books? If one believes what I have said, that this is to measure income, the best measurement of income is that which is recorded in the books and reported to the shareholders. It seems to me that for tax purposes that is the best measurement and should be the one used. However, that is not our system at the present time.

COMMISSIONER GRANT: Today, Mr. Chairman, is it not possible for a company not to take depreciation and not to disclose that in the average type of balance sheet and financial statement which is published?

THE CHAIRMAN: No, Mr. Grant. It is possible not to take capital cost allowance and not disclose it,

but it is not possible not to take depreciation, because depreciation is recorded in the company's books and on its financial statement, and therefore one sees it. But capital cost allowance is a different matter. That is a technical term which one uses to speak of a write-off permitted under the Income Tax Act which is not depreciation. Do you agree, Mr. Reid?

MR. REID: Yes, Mr. Chairman.

COMMISSIONER GRANT: In any case, today a company can forgo capital cost depreciation.

THE CHAIRMAN: Yes, surely.

COMMISSIONER GRANT: And it is not disclosed in the financial statement.

THE CHAIRMAN: I think accountants now require that it either be disclosed in a footnote or in the annual report or something else.

COMMISSIONER GRANT: Certainly it should be, otherwise it is misleading to the investors.

THE CHAIRMAN: I quite agree. Then I think we have explored your views on depreciation, Mr. Reid. The important point is that you would relate these to what is on the financial statements.

MR. REID: Yes. That was an important omission.

THE CHAIRMAN: It did cause me to take off pretty fast when I saw it, and whether one would ever achieve economic benefits in proportion to the taxes conceded I would have some misgivings about. But if one tied it to the account I agree with you that they would not all jump to 100 per cent, although I think a

lot would.

MR. REID: There would be exceptional cases where a cash capital turnover was required to expand the business and expand the profits.

THE CHAIRMAN: Expense accounts is next. I do not understand what you mean in paragraph 72, where you recommend "that travel expenses and related promotional/entertainment expenses, other than strictly transportation and bed, be regarded as an incidence of the income of the individual incurring such expenses". That is for business purposes. Deductible expenses would be restricted to travel and related promotional/entertainment expenses. I do not follow that.

MR. REID: Perhaps I might explain as this is a little obscure. Two or three of my associates have gone over this brief since I submitted it, and unfortunately I did not read it beforehand.

This is one point which was brought up, and they suggested that I was a little naive in my thinking. I am still not convinced that I am, provided, of course, that the steeply graduated tax between $10,000.00 and $50,000.00 is altered to a proportional tax, because these things go hand in hand.

If a travelling salesman was given an expense account today, let us say of $2,000.00, this is to cover travel, hotel and food. It will also involve taking Mr. Jones, one of his special accounts, out to the Maritime Grill in the Ritz, perhaps, or even go further than that and involve a $50.00, $60.00, or $75.00 evening. This extra expense and the travel, bed

and board becomes an incident of his salary. In other words, this is a payment to him in his salary. He is earning $10,000.00 a year, and the portion which he spends on promotional expenses above travel, bed and board increases his income to $10,500.00 or $11,000.00. It is true that his company will say: Well, look, Mr. Salesman, we are going to add an extra 15 per cent to what we normally pay you, and that will cover the tax payment you are going to be out at the end of the year. At least, there is a bit of discipline going on internally in the corporation, especially when this successful salesman is approaching the $50,000.00 level, when any excess is going to start attracting a pretty heavy additional tax of 50 per cent.

I think that while this proposal as it is here might be a little naive, there is some sense to it in that corporations or an employer will watch the expenditures a little bit more. The employee, the salesman or the executive who is spending the expense account money is going to be pretty careful how he spends it, and when he does have to spend it it is going to make more of an impression on his customer, because the customer will notice that it is coming out of his pocket. I think there would be a tendency to economize a little more than they do today.

THE CHAIRMAN: The customer cannot think it is coming out of his pocket because it is not, it is not of his employer's pocket. The only thing coming out of his pocket is the tax.

MR. REID: Yes, but it is shared a little more

by the spender.

THE CHAIRMAN: Would it not be simpler and more convenient to put the penalty on the employer rather than on the employee by disallowing these items as expenses?

MR. REID: Disallowing it entirely? In that case it could be added as a further reward to the employee, could it not? No, if it was disallowed as an expense that is a good thought.

THE CHAIRMAN: They have tried to do this in the States. There are forms of all kinds listing things which are allowable so as to keep it down to reasonable limits. They have even got to the point now where unless you have a business conversation immediately before your dinner you cannot charge it up. You can carry it really to the point of absurdity, but if one is going to police this thing you have to make certain rules.

MR. REID: And they get broken so easily.

THE CHAIRMAN: Yes. But the Americans are trying to make rules and to enforce them.

MR. REID: May I read what one of my partners had to say about this expense account business. He said:

"I like your idea here, but what happens in the case of travel in other countries? For instance, in travel in the U.S.A. as a director at the expense of a certain company generally, also

for the 'Financial Analyst', to say nothing of another company. Forgetting about the latter, how do I convince them to increase the expense allowance enough to compensate for my increased tax thereon?

I think your bed and board idea will lead to all sorts of crookedness, just as the present charitable donations receipts from all sorts of small religious bodies lead to false receipts. I know of no sure way of eliminating evils of expense account living except by drastic reduction of taxes."

The proposal which I have made on personal entity tax would be a drastic reduction in taxes.

Perhaps I might read one further comment:

"Your suggestions as to expense accounts I think are somewhat idealistic, but I agree that there can be considerable improvement over the present system".

But this is where we start again: How do we improve it?

THE CHAIRMAN: Well, let us move on to capital gains.

MR. REID: I think it would be advantageous, Mr. Chairman, if we have a business entity such as is proposed, because capital gains are very hard to define. This is our problem today. In effect, a producer of products is processing and buying a commodity or raw products at a certain level, and processing them. That involves a certain amount of labour. But he converts that product into something else and sells it for profit. He has invested capital. He sells it again for profit.

On the other hand, a real estate firm will buy a piece of property and resell it again. That is considered income, but that is a capital profit. It is simply in the hands of a man who is engaged in that particular enterprise. A business entity would be a person engaged in commerce or a profession as defined under the Income Tax Act now. There is a reference here to it. Therefore, enhancement of his expenditure or investment, or I should say returns over expenditure and investment, would be profits which would be taxable.

I think that to impose a capital gains tax on the population as a whole would be extremely frustrating, and I do not think it would achieve a revenue that would be equal to the cost of collection. This is hell. Where accounts are audited as I suggest here, with a business entity, even if he is a racecourse tout, he is nevertheless a business entity and must employ a certified accountant to audit all his books and to certify his return for tax purposes. Where you have that sort of internal policing then you can control

the profits on capital as well as profits on services or industry. I think that a capital gains tax, being income in this case, could be dealt with effectively.

THE CHAIRMAN: That may well be, Mr. Reid, but I have some serious misgivings about it. The United States has a capital gains tax. Most European companies have a tax which is directed against speculation. They have set up measurements against speculation, measurements which probably we would not like because they are based on the time factor, although we have all kinds of measurements to decide whether or not transactions are taxable.

When we come to your paragraph 83, which really goes to the fundamentals of what you say, it is recommended that capital gains not be subject to tax in the hands of a personal entity. Then you say: "Should gains result from activities defined by law as constituting profits of a business entity, the personal entity would be deemed to be a business entity", and so on. That is where I think we are in trouble, and I do not think that this takes us out of that trouble. The law has not been successful up to now in defining when it becomes income. It speaks of income as being the profits of the business and stops there. If I as a professional accountant were to indulge myself in speculation in, say, securities, I am certainly going into that business as well as engaging as a professional accountant. Therefore I would have two business. But if I were to invest for my old age, I am not speculating. Then the next question

is, when does my investment stop and my speculation start. I do not think we have been very successful in solving that problem yet.

What you say simply is that if I, as a professional accountant, start speculating, my speculation would be defined by law as a business, and then my personal entity would cease and I would be taxed as a business. I think you have the same problem then as you have now, and it is a very difficult one.

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MR.REID : There is a problem there, Mr. Chairman, there is no question about that. I would like to find the section here, Section 139(1)(e) of the Income Tax Act of Canada. I have not it with me. Could you read that?

THE CHAIRMAN: "Business includes a profession, calling, trade, manufacture or undertaking of any kind whatsoever and includes adventure or concern in the nature of trade but does not include an office of employment". Those are the words which are causing everybody so much pain really, adventure or concern in the nature of trade. A lot of people think it means almost anything and really if that is pushed there is virtually no transaction you can make a profit on which does not become an adventure or concern in the nature of trade. A lot of people hold that view.

MR. REID: My inexperience with the interpretation of tax laws probably puts me at a disadvantage here but I read that to mean that an employee would not be considered to be a business entity unless he engaged in some extraneous additional endeavour which made it quite clear his employment was of less significance than his other endeavour.

An example of a carpenter who was employed two, three or four months of the year. The rest of the year he is spending his time renovating his house. His wife has a knack for interior decoration. They take this house, turn it over and the

income derived from his business exceeds his employment. Then, there would be little question that he would be deemed to be a business entity. That is the way I think or perhaps someone would interpret it.

THE CHAIRMAN: I think if you took that problem to your lawyer he would come up with a long line of cases, You would be very perplexed and he would too as to whether or not this selling of that house was taxable or not. There have been a lot of people who do exactly what you are speaking of. I think there have been cases where they have been taxed, probably depending upon the frequency. I don't know. For some reason they have not been taxed. I think it depends on frequency, whether or not you moved into the house, used it yourself and it is your house. Mr. Grant is a lawyer and he may want to elaborate on that.

COMMISSIONER GRANT: I think I certainly agree with your test as to frequency, also I think the object for which the house was purchased. What did he have in mind. That has a great deal to do with it.

THE CHAIRMAN: Yes, they try to look into a person's mind at the time. That is a pretty difficult thing to do. This is a very tough area. Really I think you have left it in the condition in which it is because you say you would move a man from one cabinet to the other cabinet. That is nice and neat to have him taxed this way or that way. I

don't think it is much neater than the way it is now. He is either being taxed or not taxed now. It is either black or white.

MR. REID: Except attached to this would be a different concept of a business entity which would include corporations.

THE CHAIRMAN: You would change this definition.

MR. REID: Yes.

THE CHAIRMAN: You would not have "an adventure or concern in the nature of trade".

MR. REID: It is proposed a business entity is used to define all Canadian corporations (including Crown corporations), co-operatives, partnerships and individuals engaged in any profession, calling, trade, manufacture or undertaking of any kind as defined in Section 139(1)(e).

THE CHAIRMAN: Then you still have your business entity to include of things I have mentioned and an adventure or concern in the nature of trade.

MR. REID: Yes.

THE CHAIRMAN: Thank you very much. I am afraid we are left with "adventure or concern in the nature of trade". Now, the next thing I would like to look at is sales tax and in this particular area I notice in paragraph 89 you say one could hardly apply this description to our present jungle of variable applied, exempted and rated sales tax which is undeniably discriminatory, inequitable

and economically expressed to comply with and to administer." And you include two letters which you have received about troubles on the West Coast in regard to certain matters.

Mind you, sales tax anywhere in the world has some awful difficulties as to classification, as to two different items one which is, if you like, a recognized food and another which you could argue is a food and which for some reason or other is not classified as food in law.

When you are dealing with hundreds and hundreds of thousands of items there are many different things which you are putting into one classification or another. Almost any instrument you can conceive as a matter of fact raises the same sort of troubles. Certainly there is a lot of trouble at the manufacturer's level.

COMMISSIONER WALLS: I am going to be particularly interested in checking up on this case of the marble with which you had some trouble. I have not seen a reference to marble whether it is used as a fireplace, a floor or wall except it does not now carry the 4% tax so it must be a special article.

MR. REID: Yes, it just happens this man was doing quite a bit of work for me and he was complaining one day about the confusion. He simply did not know where he stood. I said well, tell me a little bit about it and he told me

substantially what he has stated here. I said would you write me a letter on that and the same with General Paint. In the case of General Paint Mr. Mackay is probably a bit more acquainted with tax. In the first place he is a chartered accountant. Secondly, he was a tax assessor for the Province of British Columbia many years ago. He is really quite upset about the position of his company so far as sales tax is concerned.

THE CHAIRMAN: You would go over to the retail level for sales tax.

MR. REID: In my innocence, it would seem that this would be the most practical way of collecting sales tax revenues because it is being collected at this level by many provinces and it would seem that the cost of collecting could be shared. I think the Province of British Columbia pays 3% collection costs to the collector.

THE CHAIRMAN: There are a lot of companies and people who come before us that recommend a change to the retail level. Many of the leading authorities believe it is the right way to do it.

COMMISSIONER WALLS: Except there is one difference or one apparent difference here because in paragraph 94 there is an invisible sales tax. When I read the paragraph I couldn't decide whether you wanted an invisible sales tax or not. The heading of the paragraph is: "an invisible

sales tax". There is no mention or advocacy as to either an invisible or a visible one.

THE CHAIRMAN: Provincial ones are visible.

MR. REID: Yes.

COMMISSIONER WALLS: When you say an invisible sales tax, what do you mean, at the retail level; a hidden tax?

MR. REID: I should not have included these last two paragraphs, 94 and 95. I felt impelled to say something about the inequitable cost of financing of so many consumer goods. That is what I call invisible. It has no relationship to sales tax itself. If you will notice here I have suggested that the base be broadened to include all commodities with the exception of foodstuffs and services. This would involve legal fees, trustee's fees, fees of all professionals and any form of service. The fact of broadening the base I think, would allow the rate to be considerably lower. I have no base for calculating my suggested revenue from the source and it is pure guesstimation.

THE CHAIRMAN: We have had many computations.

MR. REID: I am sure you have.

COMMISSIONER WALLS: This is not actually bad considering you are going to cut out all the exemptions except food. It has been estimated that with the current exemptions it would be

in the neighbourhood of 8%. If you eliminate all the exemptions except food and add services, you would surely be quite close or as close as possible to the 8%.

MR. REID: It is heartening to hear that. For the provincial levies it would mean a sales tax level of around about 10% in many of the provinces. Basically, I am not really an advocate of sales tax. I feel it is a very definite cost to the consumer and in turn a cost to production. It is a cost transferrable to the manufacturer but in the initial instance I think that some measure must be taken to hold up the level of the revenue and this seems to be a practical method for several years until we find another way of producing the fiscal revenue without harm to the general economy.

THE CHAIRMAN: This will not do it, will it? You have knocked a good deal from personal income tax. You have knocked out a tax on dividend income. Your 5% is not going to make that up on sales tax.

MR. REID: Again, I have no truly factual base for my guesstimates but I was guessing --

COMMISSIONER WALLS: I would have thought that further on in paragraph 107 where you deal with export trade you want the sales tax taken off machinery for production and that is another $140 million we have got to find.

MR. REID: The assumption I made, it is

not a very sound base, was that we would raise the sales tax revenues from 12% of total revenues to 21.2%. Your analyst can see how sound that is or what taxes would be required to produce the necessary revenue to offset the other reductions; but if you feel that 5% is fairly realistic and it would produce this amount of revenue, then it would seem to wind up with the total revenue being on much the same basis as is being produced today.

THE CHAIRMAN: Generally speaking, you are producing from what you have here something like $200 million per percentage point. If we need some more money, we can readily compute whatever is necessary. I would guess you would need a couple of more percentage points from what you are knocking out.

Estate tax. Your recommendation is that 50% of an estate succeeding to a spouse be automatically excluded. We have heard that elsewhere. You are satisfied with the $60,000 exemption as it stands.

MR. REID:
I have not a view on that, Mr. Chairman, because I feel that other people are more capable of analysing the position of the estate tax, so I would rather not comment on that.

I do feel, however, that the exemption should be related realistically to the real value of the dollar. Let us say, a $50,000 exemption in 1940 should reflect a $100,000 exemption today, in round figures.

THE CHAIRMAN: Then we come to repatriation of Canadian equities. That is something to which our attention is directed in our instructions. In paragraph 104 you say:

> "It is submitted that great impetus would be given to the repatriation of foreign-owned Canadian equities:
>
> (a) by removing the non-resident withholding tax on all interest payments abroad;"

That is to say, it would be more favourable for non-residents to buy fixed income Canadian securities and they would be induced to convert their investments to bonds rather than equities? That is what you have in mind there, I think.

MR. REID: That is correct.

THE CHAIRMAN: Then you say:

> "(b) by imposing a 15% surtax on investment income (other than Canadian dividends) of personal entities".

You are taxing the non-resident there to discourage his buying equities. You are trying to put him in the other direction. Have you in mind that such a tax on a non-resident would put him in the position of saying that he, as an equity holder in a Canadian company, is paying more tax than a Canadian equity holder in a Canadian company? They are both suffering the business entity tax, the 50% tax, and then the Canadian after that pays nothing on his dividend income and the non-resident would pay 15%; is that not right?

MR. REID: This is correct, Mr. Chairman; but in a sense it is leaving the situation status quo so far as the non-resident owner of Canadian equities is concerned. We do not disturb his situation. We do not bring anything in that is unfamiliar. He is accustomed to the withholding tax at the present time. But we do encourage him to make capital available for loans to Canadian business.

This is not directed to our friends south of the border only. There is money in Europe that is available. I understand that Switzerland, within certain limitations, has money available at a lower interest rate than we make available. By reducing the withholding tax on interest, I mean in all fields of interest, mortgages, bonds, debentures, notes, obligations of any sort would attract capital, I am certain, to Canada. By borrowing money to increase our production, increase the wealth of our

equity, we in turn in due course can repay it out of profits.

THE CHAIRMAN: That does not quite answer my questions.

MR. REID: I am sorry, Mr. Chairman; I must have missed your question.

THE CHAIRMAN: You have answered it in part. You say, in reply to my concern over causing the non-resident to pay more Canadian taxes than the resident, that you are not changing the position of the non-resident with regard to income from equities?

MR. REID: Yes, Mr. Chairman.

THE CHAIRMAN: With which I agree. We have changed the position of Canadians a great deal, because he would not be paying tax on dividends. Conceding what you say, that the non-resident is exactly the same, but the Canadian is better off, I think I still, if I were a Canadian living on dividend income only, would be a little unhappy to have a non-resident, who does not live in Canada at all, the fellow who lives abroad, suggest that he is paying more of a share to the Canadian government than I am paying. Does that not cause you concern?

MR. REID: That does not cause me concern, Mr. Chairman, because they are too different situations. One is a domestic taxpayer and the other is a foreign investor in the equities of Canada, and in most cases, as far as foreign ownership

is concerned, there is a reciprocal arrangement where he can recover a proportion of his withholding tax paid to Canada. That is not true in all instances, but I think this situation predominates.

THE CHAIRMAN: And I suppose one perfectly good answer to it is, "If you do not like that, do not buy Canadian equities"? I am not sure it is a very good answer, but it is a partial answer.

MR. REID: He can always sell his Canadian equities and buy bonds which attract no tax at all. An interesting thing that might be observed is that foreign owners of Canadian bonds might have to pay the same tax anyway, because that withholding tax is recoverable in many instances; but we must consider insurance and eleemosynary funds which are tax free. These investors, and very substantial investors, would have quite an increase in their net revenue. So it would encourage them to place capital in Canada.

THE CHAIRMAN: It has been made very clear to us that the man who buys bonds in another country is concerned with the net, not the gross. He looks at the return to him after withholding tax, so if the withholding tax were taken off, the value of the bonds would go up in exact proportion, I would have thought.

MR. REID: This is correct, Mr. Chairman, and he might be willing to pay a little bit more for those bonds where the differential might be, let us

say, the 15% withholding tax in addition to what he is willing to pay -- let me put it this way: He is paying the 15% withholding tax, and if the tax is reduced 15%, he will say, "I am willing to lend my money at a slightly lesser rate because the net is still better".

COMMISSIONER GRANT: That depends on how he comes out at the other end when he pays his tax?

MR.REID: Exactly.

THE CHAIRMAN: There was one point that you made somewhere. I think I must have passed over it. You do not concede that any corporation tax is passed on to customers or employees; is this correct?

MR. REID: This was in the supplementary issue, Mr. Chairman.

THE CHAIRMAN: Then we will come to it in the supplementary section. The next paragraph concerns the export trade. You say:

> "Business tax, in principle, does not increase the cost of goods produced for export; nor, to a significant degree, does a low rate domestic consumer tax -- "

That is why I referred to that, because I read that paragraph and said if one believes that corporation tax is calculated in the cost of goods, it does include goods for export. If one takes the contrary view, of course, it does not. It simply

supports what you said before.

Paragraph 115 seems to me to be inconsistent with your 100% depreciation argument. However, perhaps I am not being fair. You say:

> "One further thought: With respect to those industries which are still basically non-competitive yet are considered of sufficient importance to Canada's economy to justify 'assistance'-- let the assistance be in the form of direct, visible subsidies rather than in the prevailing form of hidden subsidies through invisible tax relief. Thus the true extent of assistance will be exposed to the constant scrutiny of those taxpayers who are justifiably concerned over the redistribution of the fiscal revenue to which they contribute".

If one allows special write-off, and I think you are speaking of this accelerated depreciation, investment allowances, those sorts of things which are more useful to capital-intensive companies than they are to labour-intensive companies, one has some invisible benefits as a rule. They do not appear in the national accounting; you cannot measure the extent of them; but if they were directed to subsidies one could see the cost? I think you have indicated that depreciation might go up to

100%, and you were thinking there in terms of an accelerated write-off of facilities for "assistance" purposes, the "assistance" in quotation marks as used here?

MR. REID: Not in the same sense, Mr. Chairman. The proposed optional rate of depreciation to the extent of 100% would be available to all business entities. Today we have special concessions given to regional industry, to sections of our economy such as gold mines, etc.,etc., etc. These assistances come in an invisible form.

Would it not be better, if we recognize that these industries or areas need assistance for the good of our economy as a whole, to have them file, in the normal form as they would as a business entity in any area of Canada, application that they need some extra assistance, where the government pays them a subsidy cheque and this is carried in the fiscal accounts, so that we see that this industry and this area has received so many millions of dollars during this fiscal year, and then the taxpayer can say, "Well, is that benefiting the country to that extent? I am contributing a lot towards this assistance, and yet I do not feel the country is benefiting to the extent of the assistance that has been given"?

THE CHAIRMAN: Being an accountant, I do not require much persuasion as to the merits of good accounting.

MR. REID: In other words, Mr. Chairman,

full disclosure.

THE CHAIRMAN: Yes. I think we might turn to your supplementary submission. The conclusion is mostly by way of argument, I think.

I observe that historically stocks sell at thirteen times earnings and twenty times dividends. Right now I think stocks are selling -- we asked somebody the other day about this, and this is what he said -- at 16 or 17 times earnings.

MR. REID: This is true.

THE CHAIRMAN: And the yield is somewhere between 3% and 4%. So you say we are now above the average. Your average is a long term average, is it not?

MR. REID: It is almost a century. I have used the Cowles Commission indexes dating back to 1871, chained in with Canadian indexes.

THE CHAIRMAN: What commission?

MR. REID: The Cowles.

THE CHAIRMAN: How do you spell it?

MR. REID: C-o-w-l-e-s, Mr. Chairman. It is the most comprehensive study of common stocks that has ever been made, to my knowledge, to date. It was published in 1938 by Principia Press in Illinois. I can supply a copy to the Commission, if you would find it interesting.

THE CHAIRMAN: I will look into it, but thank you very much. We might take you up on that offer.

MR. REID: This study covered all the

stocks listed on the New York Stock Exchange, including those that failed, split up, merged. It took into consideration every stock listed on the Exchange from 1871 to 1938. It was quite a study. The conclusion was at that time that the U.S. economy had matured and was barely holding its own, and the prospect for the future was rather grim. And that was in 1938.

THE CHAIRMAN: Saved by the war, I suppose?

MR. REID: Yes.

THE CHAIRMAN: With regard to your argument as to a 100% dividend tax credit, which is really what you have recommended already, because you have eliminated dividends from tax, which is the same thing --

MR. REID: Yes.

THE CHAIRMAN: -- that is because you suggest that all corporation tax is borne by the owners in the final result?

MR. REID: That is correct.

THE CHAIRMAN: That would not be true, I think you would agree, if prices were higher because of corporation tax, or if it can be measured that prices have gone up when corporation taxes have increased, or have gone down when corporation taxes have gone down? Would that not indicate to you that some of the corporation tax has been passed on, has been taken up in the price of goods?

MR. REID: I have rather a strange theory about this.

THE CHAIRMAN: Let us have it.

MR. REID: I am not convinced now that my foundations are as strong as I thought they were originally. But my theory is that corporation tax in principle -- I am not speaking of the cost of compliance, because that unquestionably is a cost -- is a royalty and that it is a dilution of capital rather than a cost of business. This dilution of capital is to an extent offset by depreciation of assets purchased by the owners or the investors of the capital. Over a period of time the business is able to regain much of the capital that has been employed in the business.

My belief is that cost is not transferable to the consumer because it is on a net basis; that if it were transferable it would have to come on substantially a gross basis. These are not tied in perfectly, but a transferable cost has to be before taxation. I feel that if there is some transfer of cost, it is so indistinct and so benign that it is not harmful to the economy. Competition pretty well dictates the margin of profit a company will make. If they are an efficient producer and they have almost a monopoly in their field, their margin of profits is going to be to the highest extent that the traffic will bear until competition comes in and squeezes them down. I do not

think it is taxation that affects the profit margin; I think it is efficiency, competition.

In any event, I do not feel that the corporation tax is as harmful to the economy as any other tax. I think it is the most benign of them all and the most acceptable politically.

THE CHAIRMAN: You are at the opposite pole from a great many people who believe that it is perhaps the worst tax.

MR. REID: Yes.

THE CHAIRMAN: You have probably read some of the statements that people have made to us. They say it is perhaps the worst tax because of the difficulty of knowing of its incidence and as to who bears the tax. It has been, of course, pointed out that in the case of regular public utilities it is recognized as a cost and is inserted into their costs and their rates and is reflected in their rate of return, having regard to the cost and having regard to a fair rate of return, including the cost of the tax.

That is perhaps the most obvious case where it is passed on.

MR. REID: I think that is very true in that instance.

THE CHAIRMAN: On the other side are the people who point out to us that Canadian taxes cannot be passed on because prices are set outside of Canada in the world markets; but as against that there

are taxes levied by other governments against the competing companies.

The studies that there are -- and there are many of them -- are not uniform, save only, I think, in the respect that most of them suggest that some of the tax is passed on to the customer, probably some to the employees. Some studies say that more tax is passed on than others. Some say it is passed on quicker than others. The general consensus, as far as one can tell, is that there is very little immediate effect of the tax rate on prices. There is probably a long term effect.

MR. REID: The interesting thing is that if you receive these Cowles indexes you will find that income taxes have virtually no effect on the earnings and dividends of companies. You can go back prior to income tax, to 1871 -- and I think that tax started in the United States in 1917. Then subsequently the tax has been increased to quite a burden. Yet my studies show that the average dividend paid by common stocks -- and this is taking all stocks across the border -- was about 5.3%. Breaking that down into a 15-year cycle, this rate was most consistent. The dividends related to earnings were about two-thirds. So the earning power and the paying power of corporations over the long pull has remained practically constant, despite the impositinn of taxation.

It may have evolved that had there been no corporation tax there would have been a greater growth of equity. This one can only assume, but it seems logical that this would have been the case. On the other hand, somebody might argue that profits would have been curtailed by sharp competition. That, again, we are delving into the clouds. I think it is awfully hard to prove one concept over the other. But it has not appeared to have hurt the investors.

THE CHAIRMAN: I think some people believe that earnings and dividends are exactly the same as they would have been if there had been no taxes, and I think that is perhaps what you are saying.

If that is so, I would have thought it meant quite clearly that the impact of the taxes has been on somebody other than the investors.

MR. REID: Again, the use of borrowed capital has been greater since taxation than prior to it.

THE CHAIRMAN: We had the figures before us the other day that in Canada corporate borrowings are in the neighbourhood of $400 million a year. The total increase in corporate equity per year is something over $3 billion, I think, having regard to the accumulation of earnings and also the issues of stock. So while there have been borrowings, the

real increase in the assets has come about in the equity segment.

MR. REID: And appreciation, of course, has helped the growth of the equity too.

THE CHAIRMAN: It has helped to maintain the assets.

MR. REID: Yes, to maintain the assets.

THE CHAIRMAN: I was not quite sure of the meaning of your Table in Paragraph 143. Perhaps I have not studied it very closely but it might perhaps be a good idea to have a closer look at it now and see whether I do understand it clearly. It is headed "1963 'corporate/personal' income". Do you mean 'corporate and personal income"? The heading is "Corporate/personal" income.

MR. REID: It says "corporate/personal". There should be "and" in there.

THE CHAIRMAN: The income has come in to a corporate firm and then gone on out to the person?

MR. REID: Yes. Let us take the case of the sole proprietor who is an incorporated grocery store, a very successful one. In the initial years, the first year of operation he has been able to earn $6,1000.00 only. Let us pay him the entire amount received from his company as a salary. When his earnings increase to $16,100.00 you are paying him to withdraw only 37.9 per cent of that and leave 62.1 per cent in the company, deferring the tax liability to the future. His rate is then held to 17.4 per cent, and it follows all the way through until we get up to $1 million, where his withdrawal for personal use would be 4.2 per cent and the retention of earnings in the company 95.8 per cent.

THE CHAIRMAN: You are assuming the retention pays no further taxes.

MR. REID: It would in the case of withdrawals in the way of dividends if he is not careful about the

way he withdraws his dividends.

What I am trying to prove here is that under the most comfortable circumstances he can adjust his immediate tax liabilties to quite a low rate. Say on a $53,000.00 basis his average tax paid on benefits would be 22.5 per cent. Looking further into the future, as he is able to defer income, undistributed earned surplus in his company in some later year when he is not paying himself any salary,he can pay out dividends to himself, paying possibly up to $12,000.00 to himself, and through dividend tax credits can escape other than the old age security tax of $90.00.

If he is a company in partnership with his wife, in the initial stage he can pay $12,000.00 to her and $12,000.00 to himself and wind up with $180.00 additional tax.

THE CHAIRMAN: The $12,000.00 being in the form of dividends?

MR. REID: Yes.

THE CHAIRMAN: Let us take the $100,000.00 example and see how it works. We divide this as to 72.9 per cent retained and 27.1 distributed?

MR. REID: Paid out in salaries.

THE CHAIRMAN: This is salary?

MR. REID: Yes. "Personal" represents salary.

THE CHAIRMAN: And the 72.9 per cent, which is not salary, is subject to corporation tax?

MR. REID: Yes, correct.

THE CHAIRMAN: At the stepped tax rate.

MR. REID: This is as exists today. This is

not proposed, twenty-one on the first thirty-five.

THE CHAIRMAN: I follow. What other taxes are you imposing on the 72.9 per cent?

MR. REID: None at this stage.

THE CHAIRMAN: All right. Then you have not received $65,040.00 which you can spend.

MR. REID: That is correct.

THE CHAIRMAN: You have only received, which you can spend, $27,100.00, less the salary, less tax on the salary?

MR. REID: Yes, that is so.

THE CHAIRMAN: Probably you would have spending money amounting to about $20,000.00.

MR. REID: Yes.

THE CHAIRMAN: There is $45,000.00. Just to finish the illustration, left in the company is the balance, and when you want to get that out you would have to pay some more tax of some kind.

MR. REID: Yes. That is if you are not paying yourself a salary in the year you pay yourself a dividend. You can pay yourself $12,000.00 substantially today and attract only $90.00 in tax. If you split the company into two, say husband and wife, you could pay yourselves $24,000.00, with $180.00 additional tax.

Now, in the interim this 72.9 per cent of the $100,000.00 could be reinvested in Canadian tax-paying corporations and accumulate more undistributed earned surplus.

THE CHAIRMAN: Certainly. But it seems to me

that we must look at what the net effective income is. When you use the word "effective" it is only truly effective if you can spend it on yourself.

MR. REID: I have used this in this form, that:

> "Net effective income includes undistributed earned surplus which, when paid out in dividends, may attract further tax. However if this surplus is reinvested in dividend paying Canadian corporations, income may be accumulated without attracting further tax until same is distributed. The shareholders, which may be comprised 50/50 solely of husband and wife, may decide to pay out dividends only when they drew no 'earned income' and the company's taxable income was $35,000.00 or less. They then could draw dividend income combinedly of some $23,000.00 with less than $200.00 extra tax to be paid".

This is just to give an example of what is possible under today's tax laws.

THE CHAIRMAN: You would have made it more dramatic -- perhaps you have later on -- in showing how much tax would be paid by the income of $100,000.00, because as you have set it out here the salary is $27,100.00, and that is the only thing on which tax is

immediately paid. No, I am sorry, there is corporation tax of $72,900.00. I am sorry, it is $35,000.00. You have set that out.

MR. REID: The $100,000.00 shows a net effective income, as I have defined it, of $65,000.00.

THE CHAIRMAN: Yes. $35,000.00 paid in tax, and if that had been earned by a person he would have paid about $50,000.00.

MR. REID: A little over $50,000.00. There would have been retained $49,705.00 versus $65,040.00.

THE CHAIRMAN: Which is $15,335.00.

MR. REID: Yes.

COMMISSIONER GRANT: Do I understand from the first column that the company earns the whole amount?

MR. REID: The company earns the whole amount.

COMMISSIONER GRANT: The third column is what the owner or owners draw out by way of living expenses or salary?

MR. REID: No, I am sorry. It is not too clear here. What I am showing is, in the first instance, $6,100.00 income. One hundred per cent would have been paid to the individual, drawn out completely. That would strip the company by paying himself 100 per cent in salary, and his tax would be $700.00.

THE CHAIRMAN: The third column would be best described as his salary, would it not?

MR. REID: Yes, salary.

COMMISSIONER GRANT: That is what the owner withdraws?

MR. REID: Correct.

COMMISSIONER GRANT: But the company has to work it off. The first column is the company income?

MR.REID: Actually it is all company income, and he pulls it out at a rate which will attract the least tax.

COMMISSIONER GRANT: I wonder why you put "personal income" in the first column.

MR. REID: It is the pool to begin with, the combined pool. If a man and his wife owns the company, the income is owned beneficially by him.

THE CHAIRMAN: Then we go to the table on the next page, where you deal with it on a professional basis rather than on a corporate basis.

MR. REID: Yes. This would apply to an executive or an employed person too.

THE CHAIRMAN: You are showing that the executive or the professional man will have a less effective income than will the owner of a company.

MR. REID: Yes.

THE CHAIRMAN: If you change that and you took out the first step, the rate would be entirely different, and this would go up. Furthermore, if we imposed some tax on a withdrawal of money out of here, again it would upset the ratio. Usually if a man has a substantial income he cannot get money out of a company at anything less than 15 per cent, and there is a 35 per cent personal rate plus dividend credit or a capitalized rate.

MR. REID: You will notice in table 4 that the withdrawal and salary varies from 100 per cent and

declines to 37.9 per cent, to 23.4 per cent, to 16.9 per cent, to 14.8 per cent, and then starts increasing to 34.1 per cent, to 43.6 per cent, when the individual tax is as much as the corporation tax.

THE CHAIRMAN: But you have not assumed that the owner of this company wishes to spend all his money earned annually as it is earned. There would be a great deal more tax to pay if that were the case.

MR. REID: That is true, but I am trying to show this, that the individual who wants to invest and to build his capital through investment has an opportunity in a corporation which as an individual he has not. What we are searching for is capital available for investment to repatriate Canadian equities. We allow an incorporated business owner to do it, but we do not allow the high earners in the professional and executive class to do it. We deny them the opportunity which the other has.

THE CHAIRMAN: You have a point there.

COMMISSIONER GRANT: This is a joint stock company, a trading company which you have here?

MR. REID: Yes.

COMMISSIONER GRANT: As distinct from a personal savings company.

MR. REID: Yes.

COMMISSIONER GRANT: Is your table worked out on the basis that the company pays this tax?

MR. REID: Yes.

COMMISSIONER GRANT: The tax on its profits. But the individual who draws the money out, is he taking

it out in the form of dividends on which he will receive a 20 per cent tax credit?

MR. REID: In Table 4 his withdrawals are in the form of salary.

COMMISSIONER GRANT: Why not withdraw it by way of dividends?

MR. REID: It would not be in his interest to withdraw a high salary and then add dividends on top.

COMMISSIONER GRANT: I grant you that, but why draw a salary at all?

MR. REID: Because he will attract a lower tax than the corporation tax.

THE CHAIRMAN: This is the optimum position.

MR. REID: Yes, the optimum position.

COMMISSIONER GRANT: This is charged as an expense, the salary.

MR. REID: This is the optimum position. Not many achieve it. Perhaps I might say off the record that this is just to give you an illustration of what I can do with my own company. I am not saying that I do it, because it does not always work.

THE CHAIRMAN: You are not alone in this. Most accountants who are dealing with private companies are required to make that kind of calculation every time they file a tax return. A man is fully aware of his options, and he endeavours to work things out so as to achieve the optimum position, as I think most people in fact do. Then you go on to show us that under your proposal the net effective income would be considerably enhanced.

MR. REID: That is correct. There is one factor here that is not considered, and which could not be considered because it is nebulous, and that would be the effect of the additional income derived from capital gains or trading profits, or whatever you want to call them, from capital profits. So that where Table 6 shows an improvement over the optimum position available today, it would be more like the optimum position today because of the extra tax which would apply on capital profits.

THE CHAIRMAN: It is amazing how closely it matches. This table seems to match Table 4.

MR. REID: Yes, it is amazing. Well, I designed it in that way. That is how I get these strange rates of 5 per cent, and an additional 10 per cent and an additional 50 per cent.

THE CHAIRMAN: I did not understand you were doing it in this way. You are saying that this is what you can do, and therefore working back to your optimum position you say that it is not fair for other people to pay more; let us see what kind of personal schedule we have in order to achieve it.

MR. REID: Let us give everyone the opportunity to make it work.

COMMISSIONER MILNE: This would be "business or personal" in the first column, would it? It could not be both.

MR. REID: Mrs. Milne,this is simply to show the case of a proprietor, in this example possibly husband and wife, who own a business. The first year's

income goes to the company, but they beneficially own all the income of the company. They can decide to segregate it and draw out to the extent that the income tax is lower in the individual's hands than it would be if it was retained in the corporation. Then as the income increases and the graduated tax becomes heavier than the corporation tax, they start leaving it in the business. Then in turn it can be reinvested in the Canadian corporation so as to receive free dividends.

THE CHAIRMAN: With a flat business enterprise the rate is 50 per cent. Obviously he pays out salaries until his personal rate gets to over 50 per cent. That is the key to this.

MR. REID: Yes, that is the key.

COMMISSIONER GRANT: This, in turn, is predicated upon tax being imposed on all earnings at 5 per cent.

MR. REID: Would you say that again, Mr. Grant?

COMMISSIONER GRANT: Your table 7, which is part of your business entity program, is dependent on the personal entity program being put into operation.

MR. REID: Correct. And also the business entity. It is a combination of the entire proposal. This expresses the result -- I have used the term "net effective income" -- with the business entity being shown as 100 per cent, and the others compare with the proposed business entity in this sense. The proposed business entity net effective income at $53,000.00 would be 100 per cent. The tax which exists

today available to a business owner would be 90 per cent, making him 10 per cent less well off today with this proposal, except that there is the nebulous extra tax of capital gains which would have to be considered.

I would think that the inclusion of capital gains for a business entity would bring today's optimum position equal to the proposed business entity. Am I talking in circles? Table 7 tried to relate these previous tables, using the proposed business entity as 100 per cent net effective income. In other words, at $100,000.00 the professional today, or the business executive today, is only retaining 72.2 per cent of what he would under the proposed business entity. The existing position of the business owner would be 94.5 per cent of what the proposed business entity tax would be.

THE CHAIRMAN: That is most interesting indeed.

MR. REID: I think it is a very simple approach, Mr. Chairman. In fact, it is too simple.

THE CHAIRMAN: I think it does not take in to consideration one element of our present taxes, namely that some taxes are getting the money out of business enterprises. I think that one would get a different result if one weighted your Table 4 with the cost of removing the money from the company. I do not know what it would be but I think it would produce a different result. Would that not be so?

MR.REID: This might be so from the practical, operational point of view.

THE CHAIRMAN: I know that when one considers

the taxes which are imposed on business profits in another country, or even in our own country, one always thinks not only of the taxes into the corporation but also the taxes out of the corporation. In view of the difference in time between the two taxes when they were imposed, I do not think you can fairly add the later tax and then weight an existing tax. You would have to make some kind of an adjustment to get the value of that later tax. You must not overlook that.

MR. REID: That is correct. Another factor which this would obviate would be the tandem ownership of non-controlling interest in several corporations. It is possible for a businessman to have a 50 per cent interest in several corporations and enjoy 50 per cent of the income from these companies in the form of dividends which have attracted a 21 per cent tax only. He can expand his 21 per cent tax base quite substantially provided he does not control any of these situations. This would not be possible under the proposed setup. It would not be possible if the flat rate of tax applied today.

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COMMISSIONER GRANT: Your proposal as it now stands would offer a great inducement for early retirement, I would suggest, to the professional man by selling his shares in his corporation. He would take out by way of capital gain the profits which he was able to retain in his corporation.

MR. REID: It would still be a professional process. Well, it is a business entity. It is rarely this in a sense --

COMMISSIONER GRANT: All the purchaser would have to do would be to change the name.

THE CHAIRMAN: He is not proposing to change company laws at all. This is only aimed at taxation.

MR. REID: Yes, it is a matter of accounting.

THE CHAIRMAN: So that it would not make any difference to the form of organization which the professional man would have. He would be just as he is now or the form of organization that the businessman would have because he would be just as he is now. Am I right?

MR. REID: You are correct.

COMMISSIONER GRANT: That is on the assumption that your plan does not lead to any inducement to leave his earnings in his company. He could take out his earnings and pay less taxes on them than he would have to pay now if he were

not incorporated as a company. He is not likely to build up much of a surplus position.

MR. REID: No, he is not.

THE CHAIRMAN: All profits under your plan come out of the business entity free of tax, save only salaries?

MR. REID: No.

THE CHAIRMAN: You pay 50 per cent on your business entity. There is no further tax in any connection with the business entity except for non-residents.

MR. REID: That is correct, yes. The earnings could be retained in the business entity in the case of an incorporated business, but the other is still a professional practice. It is an entity for tax purposes only. It does not change the legal structure of it.

THE CHAIRMAN: Mr. Grant's point is, I think, well taken. He has suggested in view of the fact in your professional practice you would not have to pay any more tax on the money that you had earned, once the business entity had paid tax, you might be more inclined to leave it in your partnership or your own firm than to take it out and you would not have to take it out to pay your personal tax.

MR. REID: No.

THE CHAIRMAN: However, as you say, that would not make any difference, really.

MR. REID: That would not make any difference.

THE CHAIRMAN: Well, I think that is all. Thank you, Mr. Reid, very much indeed. This has been most interesting and I think we have fully understood it. In fact, it is not so complex one cannot follow it clearly. You are not alone in feeling that the business entity should be taxed as a business entity, irrespective of how legal its practice. We have heard this many times before this Commission. We shall certainly consider what you have put before us and indeed we are most grateful to you for coming right across the country to see us. You have been very kind indeed.

MR. REID: It has been very kind of you, Mr. Chairman and Commissioners, to give me this opportunity to express my views. I do appreciate it and it is my pleasure to come across the country.

THE SECRETARY: Mr. Chairman, I have two briefs to enter into the record, one on behalf of Mr. E. Ernest Buckerfield of Vancouver, which I will enter as Exhibit 317 and one from the New Brunswick Forest Products Association of Fredericton, New Brunswick, which I will enter as Exhibit 318.

--- EXHIBIT NO. 317: Brief by E. Ernest Buckerfield.

--- EXHIBIT NO. 318: Brief by New Brunswick Forest Products Association.

THE CHAIRMAN: Stand over until 9.30.

--- Adjourned.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

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ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9.30 a.m. on Thursday, January 16, 1964.

COMMISSION:

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MR. J. HARVEY PERRY

MR. A. EMILE BEAUVAIS

MR. DONALD G. GRANT

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SECRETARY:

MR. G.L. BENNETT

INDEX TO EXHIBITS

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THE CHAIRMAN: Well, Mr. Secretary, I think we might start.

THE SECRETARY TO THE COMMISSION: Mr. Chairman and Commissioners, this morning the first submission is being presented by the Brewers Association of Canada. Mr. J.H. Moore, President of John Labatt, President of the Association, is here together with a number of his colleagues. He has a few opening remarks which he wishes to make, Mr. Chairman, in presenting this brief and he will introduce his colleagues.

I should like to enter this brief into the record as Exhibit 319.

<u>EXHIBIT 319</u>: Brief submitted by Brewers Association of Canada.

THE CHAIRMAN: Thank you, Mr. Secretary. Good morning Mr. Moore and gentlemen. We are very glad to see you indeed. We have read your submission with a great deal of interest and we will have a number of questions to ask you to explore it fully.

Before we get into our questioning, is there anything you would care to say by way of introduction and summary?

MR. MOORE: If I may, Mr. Chairman, I should like to introduce our preliminary remarks.

THE CHAIRMAN: Thank you. You might like to introduce your Associates at the same time.

MR. MOORE: Honourable Commissioners, speaking on behalf of all the brewers of Canada, I welcome the

opportunity to present our views on taxation as it affects the brewing industry.

Before submitting to your review, gentlemen, I hope it might be in order and also of some assistance to explain to you our particular approach, which at first glance may have appeared overly technical and somewhat confined when measured against the broad field of taxation as outlined in your own terms of reference.

However, when it is remembered that beer, while available across the country, is sold within the jurisdiction of each province under different conditions, we felt it would be of some value to describe those conditions which in large part have given rise to some of the anomalies and inequities with which the industry has been confronted in complying with tax regulations.

I would suggest, too, that when it is realized more than 40 cents of every brewery's sales dollar goes in taxation, you may appreciate our major problem -- one of having little room to compete freely in the alcoholic beverage market where price consideration virtually dictates choice of beverage.

Further, to pursue one aspect of your own mandate, that is, that of encouraging Canadian industry, I would like to point out that 99.8 per cent of the beer sold in Canada is brewed in Canada and the industry is owned by some 55,000 shareholders, 95 per cent of whom are Canadian. In addition, some 12,500 Canadians are employed within the industry, while another 60,000 (barley growing farmers, glass workers, pulp and paper workers and the like) derive a substantial part of

their livelihood from producing the raw materials and services required in the process. I should add that of all the materials used in producing our product, 97 per cent are Canadian in origin and, the brewing industry contributed more than a quarter of a billion dollars to the revenues of the federal, provincial and municipal governments during 1963.

The brief that we are presenting to you is, we recognize, a technical one associated with the particular problems of our own industry; however the brewing industry fully recognizes that its prosperity is dependent upon a prosperous Canada and the brewing industry endorses any modifications of the tax structure which will ensure a steady growth of personal income through better employment opportunities.

I mentioned earlier that price is one of the major considerations when consumers purchase alcoholic beverages, and if I may proceed on the premise that people will always seek some social beverage, it is our contention that the consumer should be given some guidance in his selection, if in no other way than by the price and/or taxes he pays. What is of particular significance in this latter connection, we think, is the fact that consumers have shown a marked preference for the higher alcoholic beverages with all of the attendant social implications when price is not an important factor. We have striven to show within the brief in Appendix X how certain European countries have dealt with this problem and it is meaningful, we submit, that when beer has been lightly taxed, as

opposed to wine and spirits, alcoholism has been markedly reduced and I would refer you particularly to France, Switzerland and, more recently, the United Kingdom and Sweden.

In these particular countries and other European countries the brewing industry, producing as it does products which are considered, or virtually considered, as a necessary part of every day living, the industry is highly regarded, highly respected, and neither it nor its products are in any way considered permissive. We submit to you that today in Canada the brewing industry is entitled to this same standard; that it is a well run Canadian industry making a legitimate product in a legitimate way, and that it should be treated as such and not in any way permissive.

I would like to refer to our conclusion for a moment where we indicate that the brewing industry is entering a stage where its prospects for growth are somewhat uncertain. Through a process of consolidation -- that is, from a number of small companies to one, two or three larger companies -- it has been able to absorb increased costs and some increased taxes, but it would appear that this process of consolidation is now complete and this device will not be available to offset further cost increases.

The various governments of Canada, unlike the governments of many European countries, have not seen fit to encourage the consumption of beer in the interest of moderation. Experience in many European countries indicates that the encouraging of beer

consumption eliminates many social problems while at the same time providing the public with a moderate alcoholic beverage.

The brewing industry of Canada believes that excessive taxation of our products is a major factor in discouraging consumption. We honestly believe that beer should be taxed like any other beverage and not just as a major revenue producer. The brewing industry suggests that the level of special taxes related to special products should be designed to lead the population of any country to moderate and progressive social habits.

At this point, and with your permission, I would like to enlarge on a basic premise of the brewing industry, namely, that selling a consumer product it is vitally dependent on as high a measure of full employment in Canada as it is possible to achieve. The brewing industry recognizes that currently Canada is enjoying an increasing level of economic activity, but the brewing industry is concerned not only with short term problems in the Canadian economy, but with the solution of the long term problems and primarily with the provision of employment for the many Canadians who were born during the late war and post-war years who will soon be seeking employment.

We suggest that under present tax policies the Canadian economy will not be sufficiently buoyant to provide these Canadians with a satisfactory standard of living; and I hasten to say here that this standard of living should be provided by job opportunity and

not by way of unemployment insurance benefits. We further suggest that this group of Canadians should be encouraged to develop the skills required in a modern industrial economy.

Based on these two points only, the brewing industry in Canada urges your Commission to seek ways and means of recommending tax policies which will encourage young Canadians to seek proper training for modern industry, and encourage Canadian industry, particularly the manufacturing and processing section, to develop in such a way that there is a full measure of employment for all Canadians. In our opinion, each of these objectives require greater incentives than are presently available. These incentives could be provided by major reductions in direct taxation and we urge you to direct your thoughts to these objectives, rather than to merely balancing government income and expenditures.

In conclusion I would like to introduce the members of our delegation.

THE CHAIRMAN: Thank you, Mr. Moore.

MR. MOORE: On my right is Dr. Rubinyi, who has been acting as consultant for the Brewers Committee presenting this brief. Mr. Jessop is the Director of Canadian Breweries Limited. Mr. Marquis is Comptroller of O'Keefe Breweries. On my left is Mr. Tait, who is the Comptroller of Molson's Breweries and Chairman of the Committee who prepared this brief. Mr. Carson, who is Vice-President of John Labatt Limited. Mr. Jack, Vice-President and General Manager of our

Association; and Miss Brown, who is our statistician for the Association.

THE CHAIRMAN: Thank you, Mr. Moore. Might I say that we are all very conscious of the excellence of Canadian brewery products; I think they are outstanding throughout the world. You make me wonder, in your opening remarks, as to what would be the proportionate consumption of brewers' beer and wines if there were no taxes at all imposed upon them. If we lived in a Utopian age of no taxation where you could buy a bottle of whisky for 75 cents instead of $4.25, or a bottle of wine for one quarter of what it costs now, and I suppose beer would cost a good deal less, I should have expected the consumption of spirits would go up considerably above consumption of the other two. Spirits are, I think as a matter of policy, very heavily taxed so as to encourage the consumption of the others. Would you care to comment on that?

MR. MOORE: I think that in our submission we almost have the answer to that. If the tax were at a level where spirits were priced relatively low with respect to other alcoholic beverages, their consumption would increase.

THE CHAIRMAN: What country would that prevail in?

MR. MOORE: Virtually every country. What do you say about that, Dr. Rubinyi?

DR. RUBINYI: Mr. Chairman, we are presenting this information of the relationship between the price

of beer and the price of other alcoholic beverages. We are attempting to show the different positions in the provinces of Canada. Our information shows that whenever the percentage on beer, expressed in the same percentage on spirits, is lower, then the consumption goes up of beer. This is not the case in every province, but it is in most provinces, and we think it is quite clear that any change in the price relationship between beer and alcoholic beverages would lead to increased consumption. To answer your question as to what would be the proportion in the future, of course we do not know exactly.

THE CHAIRMAN: My question was if there were no taxes whatsoever, the ultimate, would there be more consumption of spirits than there is now?

DR. RUBINYI: I think the beer consumption would be considerable.

THE CHAIRMAN: I would have thought just the opposite, because it seems to me that we tax spirits so high that our intake of alcohol is limited by our monetary capacity. Therefore in this hypothetical case we would take in more spirits. Is that not right?

MR. MOORE: I would agree I think, Mr. Chairman. I think we are living in a somewhat moronic existence.

THE CHAIRMAN: That is an entirely hypothetical question, but I did want to push it to extremes to start with. Now we can get back to work.

COMMISSIONER WALLS: Perhaps an example of what the Chairman is asking might be England in the

eighteenth century, where they all drank a lot of gin because it was so cheap.

COMMISSIONER GRANT: I wish the Chairman would tell me where I could buy a bottle of scotch for four and a quarter.

THE CHAIRMAN: In this brief. Is not that the price you put on it? It is $4.60 or something.

MR. MOORE: That is not scotch. That is spirits.

THE CHAIRMAN: Yes, that is spirits, I am sorry.

Now, I think we might skip the summary in the front. The recommendations really start at page 13, do you agree, Mr. Moore?

MR. MOORE: Yes.

THE CHAIRMAN: That is where you mention your 12-1/2 per cent discount. This problem is one which is not a new one. I can remember it arose ten years ago. I am not sure whether it was the precisely same problem ten years ago, but I expect that it is very much the same. Is that right, Mr. Moore?

MR. MOORE: Yes. One of the problems is that it is not consistently applied across the country.

COMMISSIONER WALLS: With respect to this matter of it not being consistent across the country, first of all this 12-1/2 per cent is a wholesale notional discount. I presume that in most provinces you sell to the Liquor Control Board, who in effect wholesale it either to their own stores or to other licencees in most provinces. The fact that there might

be a variance in the province from which you get the 12-1/2 per cent, as against the other provinces, has that anything to do with the fact that in the provinces that you do not get the 12-1/2 per cent there is more than one wholesale outlet?

MR. MOORE: Mr. Tait, can you speak to that?

MR. TAIT: The answer to your question is that it might be fairer to compare Saskatchewan and Ontario. Ontario is dealing, as you know, with a Brewers Institute or Association which wholesales beer to the public, and also distributes to tavern keepers. In Saskatchewan the brewer sells directly to the government, but it is still wholesaled to the Saskatchewan Brewers Association. I do not think there is a great deal of comparison between Ontario and Saskatchewan, yet 12-1/2 per cent applies in Ontario but not in Saskatchewan.

COMMISSIONER WALLS: If you have more than one wholesale outlet then you have to take your established wholesale price rather than discounting the price that you sell to the Liquor Control Board, discounted by 12-1/2 per cent. I wonder whether that has a bearing on it, because it seems to me actually that your industry is perhaps doing rather well. The distiller sells to exactly the same outlets in many of these provinces, to the Liquor Control Board, but they get no 12-1/2 per cent. They have to pay the sales tax on the full price to the Liquor Control Board. I am just wondering if the provinces that are getting the 12-1/2 per cent creates the position that

perhaps they are getting something which the others are not getting, and rather than there being a disadvantage in two provinces there is an advantage in eight.

THE CHAIRMAN: You are suggesting that equity might be better achieved by removing the 12-1/2 per cent.

COMMISSIONER WALLS: That is right.

MR. MOORE: You have to look at the physical movement of the beer. The brewers perform all the wholesale services. They deliver to the government retail outlets and the licencees, although in theory the beer moves to the Liquor Commission on paper. But the physical movement of the beer is not done that way, just the money.

COMMISSIONER WALLS: Do not spirits move in the same way?

MR. MOORE: I do not know. Do the distillers deliver to licensed outlets directly?

COMMISSIONER WALLS: On the basis of the representations here. Seagram's deliver direct to the Liquor Control Board.

THE CHAIRMAN: Perhaps the distillers should get 12-1/2 per cent.

COMMISSIONER WALLS: It should be the one or the other, it seems to me.

MR. MOORE: Whether the brewers deliver to the licencee, we in fact deliver our beer to the pub, to the tavern.

COMMISSIONER WALLS: Not in all cases you

don't.

MR. MOORE: No, but in many cases.

COMMISSIONER WALLS: I am trying to get at why the department has decided on a variation in treatment between Ontario, Saskatchewan, and parts of Quebec, as against what it does in the rest of Canada. There must be some reason for it.

You should have gone before them and given your reason.

MR. CARSON: I think that really the point you have to start at is the selling price the brewery uses as its base for sales tax, which is, in Ontario, for instance, the hotel base. This is not the price that the Liquor Control Board pays. So therefore the 12½ per cent is in fact bringing the breweries price for sales way down to a level which would be equivalent to what the distiller's is. The brewer's price in all cases where we are granted the 12½ per cent is a price which is at a median point in the distribution pattern, versus the distillery, whose price is direct to the Liquor Control Board in all cases.

I think you have to look at the base price that is used in arriving at the sales tax cost. We have done a very detailed study in the industry in the last few years. There is no question of the industry getting any concession on the 12½ per cent over other products. The points made here are really just a few instances where the 12½ per cent is not consistently applied. For instance, in Ontario the 25 per cent draft allowance was an arbitrary allowance supposedly to cover the costs of distribution, to prevent the brewers getting any concession as far as their own transport is concerned from the brewery to their own brewery company. They did not allow it in urban areas.

There is no real explanation for this. The Department has never seen fit to crack this. We just

point this out. I think these instances in these first one or two recommendations would all fall into this category because of the peculiarities in distribution. The department has never really kept up with these.

COMMISSIONER WALLS: How would you, then, rationalize the fact that in Ontario, where you do not get the 12½ per cent, the average price for a case of 24 beers is $3.86, whereas in all other provinces the average price is about $4.30, the provinces where you get the 12½ per cent?

MR. CARSONS: If I may correct you, Mr. Walls, in Ontario we do get the 12½ per cent on bottled goods and an allowance on draft sold within urban areas.

The only place in Ontario where we do not get the allowance is on draft sold outside of the Metropolitan area of Ottawa, outside in the country, to retail stores, distribution depots of the industry.

COMMISSIONER WALLS: Does draft not sell in these areas for the same price as it sells elsewhere in Canada? It seems to me that when I have had draft beer I have paid pretty well the same price.

MR. CARSONS: Well, the industry is paying more sales tax on the sales.

THE CHAIRMAN: I can assure you that we will have a member of our staff look at this question very carefully. It is rather difficult to grasp this during a discussion of this kind. And, as you say, over the years you have made a careful review of it,

which I imagine is available to our staff, is it?

MR. CARSON: Yes.

COMMISSIONER PERRY: Is the 25 cents satisfactory? Do you question that, or does it give rough justice, in your opinion?

MR. TAIT: Those who made the study felt that the 25 cents is not sufficient. We normally run anywhere from 35 to 40 cents and the service charge of the breweries warehouse company is considerably more than that. Why it should be restricted to the urban area as such is even more of an anomaly.

COMMISSIONER PERRY: Do you make that point in the brief? I do not see that in the section I am looking at on pages 13 or 14. I do not believe you do.

COMMISSIONER WALLS: I think they are only showing the anomaly.

MR. TAIT: We recommend, at the top of page 14, the fourth line, that it be replaced by a 12½ per cent discount.

COMMISSIONER WALLS: In the next section, dealing with Quebec, I notice that it is all done according to zones. In one place in your brief you mention that a province is a zone. Is a province always a zone, or could it be that in Quebec the reason for the different treatment is that they have zoned Quebec?

MR. TAIT: The province of Quebec is zoned for prices.

COMMISSIONER WALLS: One zone?

MR. TAIT: No, there are seven zones.

COMMISSIONER WALLS: Could that not be the reason for the different treatment in Quebec from one zone to another?

MR. TAIT: No; I would say that the pricing in Quebec is zoned for the convenience of the agents as much as anything else, making a disparity because of the distances involved. The population of Quebec, as you know is pretty well along the river and the transportation costs from, say, Montreal to the border of the Maritimes is quite some distance. It is zoned for the convenience of the agent, the middle-man, in short.

COMMISSIONER WALLS: In paragraph 38 after "zone" you have the word "province" in brackets, which would indicate that the whole province was one zone. Do you notice that? It is about the sixth or seventh line down in paragraph 38?

MR. CARSON: It is a quote from Bulletin ET 1. You can see the double quotes.

COMMISSIONER WALLS: So apparently it is not a province; any defined area could be a zone?

MR. CARSON: Yes.

MR. MOORE: I think that when ET 1 was first issued there was only one price in Quebec; but I do not know that for sure.

COMMISSIONER WALLS: Your next paragraph deals with ET 1. ET 1, as I read it, is a general bulletin. In fact, it was about one of the first bulletins that was turned out. In this case you are dealing with returning goods when you mention ET 1,

and I cannot find anywhere in ET 1 where it specifically deals with your industry. It deals with returned goods.

As far as we can find out, I believe there are no specific instructions issued by the Department of National Revenue covering beer returns.

Before you answer my question on this, just what do you refer to as beer returns? Do you refer to merely the return of containers, or the return of spoiled beer or beer that something has happened to? What do you mean by "returned"? If it means containers, there might be some justification for the attitude that is taken. I will come to that in a moment. When you are dealing with returns, what are you referring to?

MR. MOORE: We are referring to beer which has been returned.

COMMISSIONER WALLS: Beer which has been returned?

MR. MOORE: Yes.

COMMISSIONER WALLS: Not the return of bottles?

MR. MOORE: No. This is in fact beer.

COMMISSIONER WALLS: What guidance have you had from the department that has caused different treatment in western Canada than eastern Canada on this, because from what we can find out they have never issued any?

MR. TAIT: Only through representation verbally the department has told us, and through our history returns in Ontario have been exempt; and this

has been the practice.

I can exemplify this point because only a matter of two or three years ago two breweries in Toronto were in fact claiming the return and others were not. It was that kind of a situation. We have letters to justify this. There is some uniformity coming in this matter, but it is very slow.

THE CHAIRMAN: Have you spoken to the authorities in Ottawa about this?

MR. TAIT: Oh, yes.

COMMISSIONER WALLS: The advice that they have given us is that they have not issued any instructions varying from one province to another.

Are you sure you are not basing it just on a letter dealing with Ontario and presumed it covered there and other points in eastern Canada, because there is some conflicting information in regard to this matter.

MR. MOORE: Much of this has I think been developed through practice and rulings or understandings with individual companies initially, and it is only relatively recently that this industry has joined together to solve its tax problems, when we know what has happened to everybody.

COMMISSIONER WALLS: I would think, based on the information we have received, it might be advisable if you asked for a ruling for your whole industry as to returns, irrespective of the area.

MR. MOORE: We have done this and in tabulating these before your Commission we are sort of

publicly putting them on record.

COMMISSIONER WALLS: I see.

THE CHAIRMAN: Very good.

COMMISSIONER WALLS: Going to paragraph 41 then, which is the next matter, that deals with the fermentation dip and the period in manufacture that the tax can be assessed. Why cannot it be done when it is barrelled and bottled?

MR. MOORE: I would ask Mr. Jessop to answer this question.

MR. JESSOP: Speaking from a technical standpoint, you say there is no reason why it could not be done by package, and there has been some representation to this effect.

At the present time it is a bulk dip at an intermediate stage of the process where the volume on which duty is paid is determined. Throughout the process after that the operations people in the plants are dealing with tax-paid products.

COMMISSIONER WALLS: Do you think the reason, going back to the old idea of the excise man, and so on, was to make sure that anything that might be consumed within the plant was already taxable; and if so, why could that not just as well be done at the bottling end?

Cigarette people have had the same problem as you have had, paying tax way in advance, but they are responsible for that themselves. They want to put that cellophane wrapper on all in one continuous movement through the plant, and in order to put on

the excise stamp, which you do not have to do and the others have to do, they have to pay the tax right there instead of when it comes out of the warehouse, or bond, as the case may be.

I could not see, looking at your chart in the centre -- which is very interesting -- of the process you go through, why you should, so far back from the processing, have to pay your tax, except that I imagine the government is very grateful to get the revenue six weeks in advance.

THE CHAIRMAN: Would it have nothing to do with the fact -- if my memory is correct -- that during the 1920's a certain amount of beer leaked out of the breweries and I suppose there was no tax paid on that and it got away from tax. This control matter would prevent the tax being lost if this happened again; is this not right?

MR. MOORE: I think this is what happened in those days, but probably controls were not as good as they are today.

THE CHAIRMAN: I suspect that nowadays it would be very hard for another incident of that kind to occur, would it not?

MR. MOORE: We would certainly hope so. We would like to see the tax levied on the finished product. This is the representation we have made in this area.

COMMISSIONER PERRY: At what point do you measure your own inventories of beer? It is in the finished product, I suppose?

MR. MOORE: Yes.

COMMISSIONER PERRY: After packaging?

MR. JESSOP: After packaging and after bulk, all stages.

THE CHAIRMAN: I thought you said to Mr. Perry that you measured it at different points?

MR. MOORE: From the point of view of production you measure it every time you move it.

COMMISSIONER WALLS: What is the maximum alcoholic content allowed for beer in Canada?

MR. JESSOP: This varies. In most provinces there is no such regulation. In some provinces there is. Where there are regulations regarding alcoholic content, the maximum allowed is five per cent by volume, and this is a normal alcoholic content for beer.

COMMISSIONER WALLS: I was just wondering about this. In the next paragraph, where you say you would like to get out of excise duty and into excise tax instead -- and, of course, the wine industry is under excise tax -- I was wondering if there had been a maximum alcoholic content set, whether that was the reason for maintaining your industry under the excise duty, so that the excise man can make sure that you are not spiking your beer and obtaining an advantage over your competitors?

MR. JESSOP: It is possibly the other way, sir. In other words, perhaps he wants to make sure that there is no dilution.

COMMISSIONER WALLS: Well, after our

experience with two per cent beer I do not think any of you would attempt to get down to a lower alcoholic content.

You have mentioned your position in comparison with cigarettes. You understand, of course, that cigarettes are under both excise tax and excise duty?

THE CHAIRMAN: There is a tax on tax on cigarettes, is there not?

MR. TAIT: Yes, but they do have some exemptions as of 1952. Only half is excise duty and only have is tax.

COMMISSIONER WALLS: The purpose, of course, for the excise duty, so far as spirits and beer are concerned, was to create a duty that would be an equivalent of the import tariff; and it is on spirits. In your case it is more than the 38 cents per gallon which is your excise duty. It is also added to imported beer; but they have to pay a tariff over and above that.

When you come to spirits, it is the same as the tariff, the $13 per gallon. So I presume that the reason you have the 38 cents and are put under excise duty is so as to make it comparable, and with the extra tariff maybe that is the reason you have so little competition from beer in Canada, although it could very readily be what the Chairman said when he started, that it is because of the high quality of beer.

With regard to beer, as I understand it

you do not have to keep it in bond, the same as they do with spirits. Am I right in that?

MR. JESSOP: There is no bonding at the present time?

COMMISSIONER WALLS: So there would really be no reason why, supposing the decision came based on many representations we have had, to move sales tax further forward to either the wholesale or the retail level, why beer should not really, instead of this being added to excise tax, have it added to sales tax at a higher tax level that would bring in the same revenue. Can you see any reason why that should not be done?

MR. TAIT: Move it forward?

COMMISSIONER WALLS: You are wanting to bring it one step forward from excise duty into excise tax. We have had representations to the effect that the excise tax might be eliminated because it is only another form of sales tax and other countries have a graduated sales tax.

Supposing that was done. Is there anything that would prevent beer being sold right forward, even at the retail level, with a higher tax than would be applicable to normal goods, but a tax that would make the revenue the same as it is today, as there is no bonding problem to face up to?

THE CHAIRMAN: In thatway there would be no tax on the inventories.

COMMISSIONER WALLS: That is right.

MR. TAIT: I would say a qualified yes,

subject to the premise that we feel that beer should be taxed like other products. There are no mechanical problems.

THE CHAIRMAN: You have no doubt noticed that a great deal of the representation has been to move tax to the retail level.

MR. TAIT: Yes.

THE CHAIRMAN: And you must have considered what would happen to your own product if that occurred.

MR. TAIT: Yes.

THE CHAIRMAN: And I am glad to hear that you do not raise any particular difficulty, because it is certainly something that must be weighed.

MR. CARSON: I would like to comment referring to the field to which you referred you would be correct in that one of the serious anomalies which the industry faces is the spiraling effect which applies on the duty where we would get a double-barrelled increase when the sales tax is raised. in the duty and sales tax.

THE CHAIRMAN: I am not very impressed with that argument. We have lots of taxes on taxes. I can accept the view that the spiraling would make you want to change the tax base.

COMMISSIONER WALLS: One of the big problems we are facing is that everybody wants a reduction. We are faced with the problem of raising the same amount of revenue. Of course, we will deal with that later on in the brief where you introduce that. I think in dealing with that I also dealt with the problem of paragraph 44 as well.

THE CHAIRMAN: You have no reservations as to the fact that if you move into beer it could be properly controlled to the satisfaction of the government with excise taxes rather than excise duty.

MR. MOORE: There is no reason why it could not be.

THE CHAIRMAN: With the resulting economies obviously. Would all the economies be on the side of the government or would they be yours too?

MR. TAIT: Both. There are 30 excise

offices in the country. We feel both by observation and conversation with the Excise Department that this could be reduced to 22 so that would be a reasonable saving on the end side. The saving on our own side would be a lack of interference.

COMMISSIONER WALLS: You are lucky. Some of the distillers have more than that in one distillery. Now, in dealing with this disportionate share of the tax burden that is now borne by the brewing industry, as I understand it the excise duty is 38 cents. A corresponding one in the United States is 35 cents and the last figures I had from the United Kingdom were 41 cents. You say there has been some reduction in that.

MR. TAIT: Yes, in 1961, as I recall.

COMMISSIONER WALLS: Anyway they are all relatively close together so there seems to be a common spirit -- I do not make that as a pun -- between each of the countries. When we had the Distillers Association before us they pointed out the very admirable position that you were in compared with them. They stated that the excise revenue on the basis of a gallon of absolute alcohol they paid a tax of $22.75 as against you on the same absolute alcohol of $7.20. In other words they showed they paid three times as much taxes based on alcohol content; so here we have a situation where our taxes are apparently pretty well in line with the other countries that we at least do most of our business with

and the fact that in relationship to the industry you compete with you only pay one-third of the taxes they do. Have you anything to comment on that?

MR. MOORE: Well, this is the basis for our suggestion that beer should not be connected with spirits or any other high alcohol beverage and we believe you are suggesting we have.

COMMISSIONER WALLS: You do associate it later on. You point to the fact if liquor goes down in price naturally it affects the beer consumption so I don't think you can just dismiss one from the other because your sales, as you point out in your figures, are dependent upon one another.

MR. TAIT: I think in that case as far as being thrown together in the same bed I don't think that is our own choosing.

THE CHAIRMAN: I think they are saying for social reasons it would be better for us if we drank more beer and less spirits and therefore the taxes should be lower on beer or alternatively they would be higher on spirits, depending on what the government wants to do.

COMMISSIONER WALLS: I have nothing until item 52.

THE CHAIRMAN: Item 52 is the graph showing the growth of the industry.

COMMISSIONER WALLS: Yes. I note that you pay a total of 8% for federal excise taxes and duty.

THE CHAIRMAN: Have you come to this graph?

COMMISSIONER WALLS: Yes.

THE CHAIRMAN: I think it is interesting in looking at the graph to turn to the table on which the graph is based because I observe in the table -- I suppose it shows up in the graph equally as well -- that the volume of your industry is roughly the same as the total manufacturing up until the last year of the graph, 1961 when manufacturing moved up and you stand about still. Which is the table supporting your graph?

MR. CARSON: Page 57, I believe.

THE CHAIRMAN: Yes, that is it. The total manufacturing in 1960 was 126, breweries 125.9, showing breweries had roughly kept pace with the manufacturing until 1961 when they seemed to have moved forward and breweries moved up one per cent of a point. I think you make the point very well with that graph comparing carbonated beverages, breweries, distilleries, wineries, tobacco products, pulp and paper, chemical and non-durable manufacturing. On the other hand I imagine you must have an awful lot of other ones that are not on here. Your point is it does not look like a growth business in the last 10 years.

MR. MOORE: We are concerned with the future.

COMMISSIONER WALLS: Could this be

credited to other things than tax which, of course, is the point in which we are interested? How has the increase in sales been in beer in the United States, for instance? Have you any comparative figures on that?

MR. MOORE: I think the beer growth in the United States has been relatively static. We do not hold them out as a model.

COMMISSIONER WALLS: No, I wondered if this was a common trend.

MR. MOORE: Canada and the United States are relatively static. Mexico, I believe, has a good growth in beer. Many European countries are now experiencing some real growth.

THE CHAIRMAN: For social reasons, as you have indicated.

MR. MOORE: Yes.

THE CHAIRMAN: We have gone up by 2% on a per capita basis in the last 10 years from 100 to 102. Perhaps that is all we can stand, I wouldn't know. I suppose what you say is it may be better for us if we had more beer and less other things.

MR. MOORE: This is the basis of one of our arguments.

COMMISSIONER WALLS: But based on your later charts it would appear that it is tied to the standards of relative prosperity. In other words, as salaries and wages go up, there is a lesser percentage

of beer drinking and an increase in percentage of wine and spirits, although actually you have all gone up. You see, it is not as if one has gone down. The total per capita intake has increased but you have not increased to the same extent as they have and basically the problem seems to be it is connected with the standard of living. I mean the poor people drink more beer and as their salaries go up they branch out into the wine and spirits industry.

THE CHAIRMAN: You see that illustrated when you compare provincial spending to the consumption of beer.

COMMISSIONER WALLS: That is right.

THE CHAIRMAN: That is indicated over on page 25.

MR. MOORE: I would like to answer Mr. Walls' previous statement. I think what you say is true provided there is no price break for either product. With the United Kingdom experience and West Germany, there is no social stigma attached to drinking beer. In fact other countries like Australia and New Zealand prefer that.

COMMISSIONER WALLS: Is it not a problem in front of you with respect to your advertising? Could you not do quite a bit to create the fact that beer is a prestige drink to promote increased sales in the higher income brackets, because this appears to be where you are lacking in sales.

MR. MOORE: Mr. Walls, I don't know whether you are familiar with our advertising regulations. They are equally as restricted and complicated. It is very difficult to advertise in this country at the moment.

COMMISSIONER WALLS: Some of it is done very palatably when it comes to football games, I notice. The next section of your brief beyond that, of course, deals with your declining revenues, on page 27.

THE CHAIRMAN: This is an interesting survey you conducted in paragraph 63 where you endeavoured to measure taste and I think it goes to support what Mr. Walls is saying. As the income level goes up more people are going to vote in favour of hard liquor. Is that true?

MR. MOORE: That seems to be correct, again assuming no price break.

COMMISSIONER WALLS: That is right.

THE CHAIRMAN: You make the point clearly on page 25 when you say as personal income rises the amount spent on alcoholic beverages also rises but the proportion spent on beer falls. That means, I think, that your sales rise more slowly in prosperity and they would decline more slowly in an economic depression. Is there any experience to support that? Going back to 1958, what happened that year?

MR. RUBINYI: We present a table here

opposite to page 24 where we try to analyze the consumption of beer in relation to the level of the unemployed labour force. We take the case of 1954 and 1958 when the unemployment figures were the highest and the beer consumption --

THE CHAIRMAN: What page is this?

MR. RUBINYI: Opposite to page 24 -- then the beer consumption was the lowest.

MR. MOORE: With specific reference to 1958 there was a beer strike in Ontario for six weeks. This distorted any experience that may be relative statistically.

THE CHAIRMAN: That is why alcohol went up.

MR. RUBINYI: Yes.

THE CHAIRMAN: That is the real reason for the bump in 1958, the strike rather than anything else.

MR. RUBINYI: No, it is one of the reasons.

THE CHAIRMAN: Now, I thought your figures opposite page 25 were interesting. I was not altogether sure that they bore out your conclusion and I notice that the consumption per adult is highest in Quebec and the disposable income per capita is not the highest. It is considerably lower than Ontario and the price in Quebec is a little higher. Therefore the percentage of disposable income that goes to beer in the province of

Quebec is a good deal higher than it is in Ontario. Does that bear out what we are saying: namely that when the income level is low people will move more to beer than to spirits?

MR. RUBINYI: That is correct.

THE CHAIRMAN: They will take in the same amount of alcohol, no matter what they do but in a different form.

COMMISSIONER WALLS: It shows that price bears little relationship to that because again the price is higher in Quebec than it is in Ontario.

MR. MOORE: Well, Mr. Walls, there are other factors. You can drink beer on Sunday in Quebec.

COMMISSIONER WALLS: That is the point I wanted to bring out.

THE CHAIRMAN: This table leads us to the conclusion that you can consume more if you drink on Sunday. Commissioner Milne wants to ask a question about Manitoba.

COMMISSIONER MILNE: I was interested in these two particular graphs and the table because there seemed to me to be a relation here with what you bring forward in appendix 10. You speak about the government policy with respect to beverage drinking in other European countries and also to the age level at which people may commence to drink a beverage.

I was particularly looking of course at

Manitoba, Alberta and Saskatchewan on the graph, also on the consumption per adult of disposable income because it seemed to me that there is certainly in these particular areas the thought that there is a concentration of an ethnic group that have been through their cultural background and habits of their original countries, showing a predominance to drink this moderate beverage.

MR. MOORE: Yes, in part, certainly but if you have travelled in Europe and have sat in the delightful sidewalk cafes drinking beer, you cannot consider some of the beverage rooms in Manitoba --

COMMISSIONER MILNE: I do think there is a relationship here that is different and may naturally be one of the factors that makes it stronger in certain areas as well as the price and income levels.

MR. MOORE: You could be quite right.

THE CHAIRMAN: That doesn't hold up very well when you look at Quebec because the consumption of beer in Quebec is very high and the consumption of beer in France is relatively low.

COMMISSIONER WALLS: And they can both drink on Sunday.

COMMISSIONER GRANT: I take it that the price of the product would have a greater influence on the consumption than the disposable income factor.

MR. RUBINYI: You are quite right and price is an important factor. But the price itself would not be enough to analyze the situation. When we relate the situation to the disposable income you need both figures for purposes of analysis. We are saying that whenever the figure for disposable income to buy beer is lower, then the beer consumption is lower.

THE CHAIRMAN: This is the point made in the graph opposite page 26, where you explore the price relationship as between spirits and beer, and its effect on consumption.

COMMISSIONER GRANT: The low consumption in the Maritime provinces as compared to other parts of Canada is, I am sure, very directly related to the higher cost of beer in those areas. More so than it is to disposable income. While you are taking both of those into consideration you do concede that price has greater bearing on the question.

THE CHAIRMAN: In Nova Scotia, as I read the chart, beer crosses spirits in 1960, where the beer is lower than the spirits in Ontario throughout. Therefore the consumption in Ontario of beer as against spirits is lower relatively than it is in Nova Scotia at the present time. What has that to do with the price?

DR. RUBINYI: As I mentioned earlier, the figures showing the position in the provinces are not showing exactly the same position. We are really unable to explain the difference which you have just

mentioned. This is one of the exceptions.

THE CHAIRMAN: I am not sure that it is not borne out by the chart. In Nova Scotia the relationship of the beer price and spirit price declined at the time when beer crossed over spirits. In Ontario the relationship of beer price to spirit price declined in the year 1961, and spirits goes up and beer goes down. That does not seem to me to be spread.

MR. MOORE: There have been changes in regulations in Nova Scotia. Distribution and regulations have affected the lower price. Price is an important factor.

COMMISSIONER GRANT: Nevertheless I think that in Nova Scotia we did have quite an increase in the price of spirits in 1959, and there would have been a falling off due to the higher price, because spirits are higher in Nova Scotia than they are in Ontario, I note. There could be falling off in the diminishing return in beer, yet the appetite for spirits has to be satisfied, and it reflects in beer going up.

COMMISSIONER WALLS: How do you explain the relationship of beer being much higher than spirits in British Columbia?

MR. CARSON: I think we might comment on this question together with the previous one and look at the figures running from page 69 to 73. There we have a table of comparison between the price of beer and a medium priced spirit. The spread in price in B.C. of spirits has been consistently greater than in

Nova Scotia, where currently the price of beer and spirits is roughly the same. Therefore, if you relate the price back to this chart, I think it proves the point that the spread between beer and spirits is very narrow. Beer consumption is suffering.

COMMISSIONER PERRY: Mr. Moore made an important point which would appear, on this table, in every province, really, and that is the changing attitude of governments towards social consumption of spirits particularly. We all remember the excitement in Ontario when we first had the so-called cocktail lounges. Relating to that, do you have any figures in your industry for home consumption as compared to public consumption?

MR. MOORE: We have it province by province, I think.

COMMISSIONER PERRY: Well, just the position in general. What is the relationship?

MR. MOORE: In Ontario it is 70-30.

COMMISSIONER WALLS: Do you mean 30 per cent is home consumption?

MR. MOORE: No, 70 per cent is home consumption. That is Ontario.

COMMISSIONER PERRY: Do you know whether it is changing over the years, or is it relatively stable?

MR. MOORE: It is changing in Ontario towards home consumption. In some of the western provinces, however, I think it has been relatively static, 50-50 pretty well.

COMMISSIONER PERRY: The soft drinks people are finding the same thing. They are getting even more of a mass market through the shopping centres. They now think that about three-quarters of their consumption is in the home.

COMMISSIONER GRANT: In what year was the austerity tax applied to spirits? Was that 1962? It does not reflect any price increase or falling off in demand, as reflected in these charts.

MR. TAIT: I might just comment that there was a marked increase in consumption in Quebec when there was a double increase both by federal and provincial authorities in June of 1962.

COMMISSIONER GRANT: Did you say an increase in Quebec?

MR. TAIT: Yes, in beer consumption.

COMMISSIONER GRANT: But in spirits. Was there an increase in the tax on spirits?

MR. TAIT: No.

THE CHAIRMAN: May we now go to the profitability of the industry. I would like to look at paragraph 76. I was curious in that you used the term "capital employed" to include the stockholders equity, which would be the capital stock outstanding and the surplus, the long term liabilities and accumulated depreciation. Might I assume that if you were relating profit to capital, which you have done, you would have added that to the interest on the long term liabilities, and added that to the depreciation. Surely you cannot have it both ways.

MR. TAIT: Yes.

THE CHAIRMAN: You have added that to the interest?

DR. RUBINYI: There is the capital, the earned surplus section, the long term liabilities and the accumulated depreciation.

THE CHAIRMAN: But in your income, when you put that down did you add the interest which has been charged to the profits?

DR. RUBINYI: No, we did not.

THE CHAIRMAN: Did you add to your profits the depreciation which had been deducted from your profits?

DR. RUBINYI: No.

THE CHAIRMAN: Would you have any idea as to what would have been the result if you had stopped at stockholders equity and not added anything to that?

DR. RUBINYI: The percentage would have been higher.

THE CHAIRMAN: The figures would be entirely different. You do not have them, do you?

DR. RUBINYI: No.

MR. CARSON: It is the view of the industry, I think, that the important thing here is not so much income. We realize that the figure is low, but it is the trend of the industry which has been down. Even if you were to change the condition you have mentioned, and eliminate depreciation, you would still have a declining tendency in the industry.

THE CHAIRMAN: I think it would only show

the trend of the figures. It would not show the trend of profits to capital and would not show the trend of profits to sales. Because your depreciation changes from time to time, and your proportion of debt changes from time to time.

MR. CARSON: Well, there are three companies in the industry, and you realize the difficulty. It would be relatively difficult to get statistics to produce accurately without disclosing company figures.

THE CHAIRMAN: You all publish balance sheets.

MR. CARSON: One of the major companies in the industry has a fairly large U.S. business, and that has been excluded. This is an attempt to measure profit in Canada only. We have to be careful to the degree in which we break down the figures, and we have concentrated here on the trend of the return.

THE CHAIRMAN: I would be glad to look at any relationship of profits to shareholders equity, or relationship of profits to sales. I think they are all right because obviously you have used your reported profits and your reported sales. But the return on capital employed, and your turnover of capital and sales, I should like to see, using what I would consider and I think what most accountants would consider to be the capital. I think that one usually considers in manufacturing that the turnover of capital sales should be about twice. Perhaps not quite as much, but I was quite surprised when I

looked at some of your figures. In the year 1961, if they are the figures, your return on capital employed and your return in the matter of profits would be very different from 5.84. It would be double that, or at any rate 1½ times.

DR. RUBINYI: As Mr. Moore pointed out, we are mainly concerned in our brief not with the level of the profit on employed capital or the sales or assets. What worries the industry is the declining tendency. We are quite sure that if we did recalculate these figures this declining tendency would be shown very clearly.

THE CHAIRMAN: That is what I should like to see, because on these figures I do not accept the fact that there has been a decline. There are matters which would intervene here which would produce a result which I do not think is the result which is reported. If one incurred a lot of debt, for instance, or if there was a heavy expansion on the capital account, the depreciation would alter, and that would affect the decline or rise of the figures.

MR. MOORE: We would review these on the basis of Canadian profits and Canadian capital employed, as you suggest. We are trying to make up a trend on the basis of our business in Canada.

COMMISSIONER WALLS: What I am interested in is, if these figures substantiate the figures you have here and show us a declining profit anyway, would there not be a tendency if the federal government should decide to refuse your tax, to do either of two

things: one, that you withhold some of it in order to increase the return to your shareholders, or secondly, that the provinces might want to take up the slack and bring the price up to the same level that it was, so that there would be no benefit to the consumer? That would then have the tendency not to show the increase in consumption which you are looking for.

MR. MOORE: Could I just take them one at a time, Mr. Walls. We have enough faith in our products that if we could pass a price reduction onto the consumer by way of a reduction in tax we would obviously do so. We have no control obviously over the provinces, but we do try to persuade them to do this. We believe that if we could sell more beer at a lower price our shareholders would benefit through increased volume; but again, we have no control over the price. We are continually making representations to the authorities on the basis that if they would reduce their tax we would reduce our price.

THE CHAIRMAN: The figures over the page showing salaries and wages show a decline. The cost of materials has declined but the value added has gone up. I would point to the fact that your operations are more automated in 1961 than they are in 1962. Is that right?

MR. MOORE: Than they are in 1952.

THE CHAIRMAN: Yes, I mean 1952.

MR. MOORE: Yes.

THE CHAIRMAN: Therefore, the capital expenditure would have increased a good deal, and the value added by the brewing industry, the increase there would be in part an increase in the capital cost.

MR. MOORE: I think our brewing plants in Canada are as modern as any in the world.

THE CHAIRMAN: You have some brand new ones in your industry, have you not?

MR. MOORE: Yes, we have.

THE CHAIRMAN: You have made the point that your industry is not doing very well. Your profits have been pretty steady, but profits of Canadian industries generally have been fairly steady in the last ten years. I was wondering if you could give us an idea what the price ratios are of the public companies in your industry. That provides an idea of what the public thinks of your future prospects. We gather from talking to people concerned with the stock market that a fair average in this country is 16 or 17 times. Would you people, generally speaking, be in that category?

MR. MOORE: I think tradionally we have been below that. I was a little shocked to see yesterday our own company stock selling at around 18. This is nothing to do with beer; it concerned some other line of endeavour. I am sure that this is more speculative than what you might call real value based on public return.

THE CHAIRMAN: But you are not prepared to say that generally your industry is below, are you?

MR. CARSON: I think we might make the comment that it is difficult to assess the brewing industry because of consolidation of the industry. The three major brewing companies have been obviously able to attract investor capital because of the corporate structure they have built up through the spread of their investment across Canada. It is true that the average has been up to the 20 times mark, and now they are down around the 15. I think generally that the earnings in the market are closer to 20 than to 15. Really the industry is maintaining its position or even accelerating slightly because of the fact that there are these three major companies.

COMMISSIONER GRANT: I frame this question not of one particular company, but is the industry diversifying in order to create a hedge against lower profits in the beer business? Is there a tendency towards this?

MR. MOORE: I do not think the industry as such is diversifying.

THE CHAIRMAN: I am interested to see you are celebrating the 300th anniversary, or you very soon will be, of beer manufacture in Canada. As a matter of interest, do I assume, as advertised, that it started in the Jean Talon vaults in Quebec?

MR. MOORE: That is a fact.

COMMISSIONER WALLS: I note the fact that your industry seems to be pretty well divided between one-third federal government revenue, one-third provincial revenue and licences and one-third for the

cost of production. They are all reasonably uniform, are they not, the percentages which contribute to the price of beer?

THE CHAIRMAN: That is very happy, is it not!

COMMISSIONER WALLS: The only conclusion I draw is that I would rather be paying less of the tax, which is what these gentlemen are here for!

THE CHAIRMAN: Well, I thank you very much indeed. I am delighted that you gave us a flow sheet. I can hardly wait to get down to my basement to try it out!

This has been a very interesting submission indeed and it will be extremely helpful to us. Is there anything further you would like to say? Then accept our sincere thanks for this morning's attendance.

MR. MOORE: Thank you for hearing us.

THE CHAIRMAN: Then we will stand over for ten minutes.

--- A short recess.

SUBMISSION OF

THE CANADIAN MUTUAL FUNDS ASSOCIATION

APPEARANCES:

ALAN CHIPPINDALE,	President
T.O. PETERSON,	First Vice-President
A.K.G. REID,	Second Vice-President
R.B. WHITEHEAD, Q.C.,	Executive Secretary

THE CHAIRMAN: Mr. Secretary, I think we can start.

THE SECRETARY: Mr. Chairman, the second submission this morning is being presented by the Canadian Mutual Funds Association. Mr. Alan Chippindale, President of the Association, is here together with his associates and would like to say a few introductory words and introduce his colleagues.

I would like to enter this brief into the record as Exhibit 320.

EXHIBIT 320: Brief submitted by Canadian Mutual Funds Association

THE CHAIRMAN: Good morning, Mr. Chippindale. We are glad to see you and appreciate your coming forward to assist us in this matter.

MR. CHIPPINDALE: Thank you very much.

THE CHAIRMAN: We have read what you have

put before us, and we do not want to do that again. But we will have a number of questions to ask you. Before we get to that, if there is anything you wish to say to us, we will be very glad to hear it.

MR. CHIPPINDALE: Mr. Chairman and other honourable Commissioners, I would like to say that we consider it a pleasure indeed and a privilege to be here and to be able to discuss this submission with you.

With your permission, I would like to introduce my associates. But before doing that I would like to say that if I seem to be drinking an undue amount of water, it is not really due to my misbehaviour last night. I have been fighting a cold for several days with anti-histamines and I am just completely dehydrated.

THE CHAIRMAN: I am glad the brewers are no longer in the room.

MR. CHIPPINDALE: I was hoping that the people on the panel which preceded us might leave some of their products, but they did not.

First I should like to introduce Mr. T.O. Peterson, on my right. Mr. Peterson is First Vice-President of the Association and he is President of the Investors Mutual Group of Funds, from Winnipeg. On my right is Mr. Alex Reid.

THE CHAIRMAN: Whom we know.

MR. CHIPPINDALE: He is Second Vice-President of the Association. He is President of the Mutual Accumulating Group of Funds, from Vancouver. To my

far left is Mr. Whitehead, who is Executive Secretary for our Association at our offices in Toronto.

In our brief we have limited our comments strictly to the taxation of mutual funds themselves and to attempt to answer a few questions which have been raised in advance by the Commission staff.

However, if the Commission have any other questions in the area of investments and the taxation of investments, we would be very glad to comment on them if we feel qualified to do so. I do not want to introduce the whole brief at this stage, but there are one or two points that I would like to emphasize.

We have dwelt at some length in tracing the history and development of mutual funds, not because we want to bore you with them, but they are a relatively new type of operation. They are becoming more widely known, but they are perhaps not as widely known as other institutions are. Therefore we have included some brief description of their history and development.

We have also touched on the important role they play in the national economy. The assets at the end of this year, although not in final form, will have crossed the billion dollar mark among the funds which are members of this Association, which are 27 in number. Their ownership of Canadian common stocks, which seems to be such a desirable thing in this country, will run in the neighbourhood of $650 million to $700 million, and it is growing fast. We feel that is greatly more than any other investing group in the country. In fact, figures which are somewhat

sketchy seem to indicate that that is more in Canadian common stock holdership than any other two groups combined.

In essence, what we are asking for, we feel will not cause any loss of revenue to the government. It is simply a matter of trying to get uniform taxation of the several different kinds of funds, namely open-end mutual funds which are incorporated, open-end mutual funds which are not incorporated and act as unincorporated trusts, closed-end investment companies, and any pool funds that operate primarily as supervised and diversified entities for other people. So that all would then be on the same basis.

The present taxation attempts to give approximately the same type of treatment, but in the process there are some anomalies, some injustices, which we feel are not necessary.

We feel that they should all be taxed as through conduits, which we believe them to be, and should have full tax credits. We believe them all to be in the same position. This would assist them in developing greater growth through the simplicity which we feel is highly desirable, not only as a service to hundreds of thousands of investors in Canada, but also in this very important area of raising and generating more savings of the Canadian people to be available for greater ownership of Canadian enterprises.

That is all that I have to say. Thank you, Mr. Chairman.

THE CHAIRMAN: Thank you indeed, Mr.

Chippindale. I think we will want to ask you questions going beyond the technical aspects of the position of investment trust when we get on to the main part of your submission; at least, your own recommendations as to how your type of organization should be taxed.

In view of the technical nature of this matter and its great importance, I have asked our counsel, Mr. Stewart, to lead our questions, which of course leaves us with the right to ask questions too. So they may come at you from all directions.

There is one question I would like to ask you before we deal with your submission. While I am quite familiar with incorporated closed-end and open-end investment trust, or reasonably familiar, I have very little -- in fact, I think I might say no experience -- experience of unincorporated funds. Those would be in the nature of trusts, I assume; but I observe somewhere in your submission that you refer to shareholders of unincorporated trusts, which is very loosely speaking, I would assume, because if they are unincorporated they can hardly be shareholders. They can be beneficiaries of a trust, I suppose, technically.

MR. CHIPPINDALE: That is correct. That is a manner of speaking, if you will. They are unincorporated trusts and are governed by the terms of the trust . It is commonly referred to in the industry as being a shareholder in the trust, and that is the reason that terminology was used.

THE CHAIRMAN: Do they receive a certificate of any kind?

MR. CHIPPINDALE: Oh, yes.

COMMISSIONER GRANT: You could use the term "unit holder" and perhaps describe it more accurately?

MR. CHIPPINDALE: No, a unit holder in industry means something else again. A unit holder, by common usage in the investment industry, means where a fixed number of individual securities are deposited with a trustee and against that fixed number of underlying securities you issue beneficial certificates of ownership, in units.

In other words, you may have "X" number of shares of 20 different stocks, and those are deposited with the trustee, and you issue against those particular stock certificates and securities units of ownership.

You may have outstanding 1,000 of those units of ownership, but each one is an individual unit, and usually the unit holder has the right to go to the trustee and require delivery to him of the underlying securities by the surrender of his beneficial certificate. That is not what we are talking about.

THE CHAIRMAN: I think we are getting into a technical area, and that is why we have Mr. Stewart. I just wanted to get a very general idea to help me, and we will probably come back to that afterwards. Mr. Stewart?

MR. STEWART: Thank you, Mr. Chairman. Gentlemen, I would like to start, if I may, on page 9 of your brief and ask you one or two questions about the composition of your Association. You say in

paragraph 12:

> "It is estimated that 98 per cent of eligible funds in Canada...are members."

I take it, if we look at page 7, that the six companies which are referred to in the first paragraph on that page are the only companies which you consider to be eligible which have not in fact become members of your Association. Would that be so?

MR. CHIPPINDALE: If I might say so, Mr. Stewart, elsewhere in here we do describe who we consider to be eligible for membership in the Association, which are open-end mutual funds only, organized and primarily owned in Canada. It does not include any closed-end incorporated funds. It does not include any open-end funds organized in Canada but primarily owned abroad. So you get into quite a few of these. We went to considerable trouble in preparing these tables because we wanted to try to present a picture of the total of these things in Canada outside of our own Association. When we say that it is estimated that 98 per cent of eligible funds in Canada are members, we think that is reasonably correct, having in mind that our members have a billion dollars in assets. The figures we give here, do they not amount to about 98 per cent? That is what I am trying to portray.

MR. STEWART: Let me come back to my question, if I may. My question is this: On page 7 you refer to six funds having aggregate assets of some $14.9 million which, it would appear from your rules, would be eligible for membership; but I take it from what

you say on page 9 that these are the only eligible ones who have not become members?

MR. PETERSON: I think that would be essentially correct, would it not?

MR. CHIPPINDALE: I think it is essentially correct. Does not the arithmetic flow there?

MR. STEWART: I am not suggesting that it does not. I am trying to follow this through. On page 9, in paragraph 12, you say that you have excluded funds organized outside of Canada and funds organized in Canada but owned primarily outside of Canada.

Then your next classification of exclusions consists of small funds operated as ancillary to the investment counsel or investment brokerage business.

MR. CHIPPINDALE: That is right.

MR. STEWART: How do you define a small fund, in this connection?

MR. CHIPPINDALE: As a general statement, something under $1 million. There might be one or two exceptions, but mostly well under $1 million in total assets.

THE CHAIRMAN: Would those be investment clubs?

MR. CHIPPINDALE: No, those are not private investment clubs.

MR. STEWART: Would this be the group which is referred to in the third item on page 7?

MR. CHIPPINDALE: The nine companies?

MR. STEWART: Yes.

MR. CHIPPINDALE: Yes, that would include

that group.

MR. STEWART: The last item on page 12 relates to funds operated by trust companies or insurance companies or closed-end investment companies. I appreciate why you might eliminate the closed-end, because you are open-end.

Are the funds which are operated by trust companies or insurance companies in the open-end category, or not?

MR. CHIPPINDALE: For the most part, yes; not necessarily entirely. They may have some incorporated funds. As a matter of fact, trust companies generally operate what they call pool funds, which are unincorporated.

MR. STEWART: But if they are open-end why, as a matter of interest, would you exclude them from membership?

MR. CHIPPINDALE: That is a type of business different to our business. Their business is essentially not the mutual fund business. It is just a small ancillary to their business, and as members of our Association this is our primary activity. That is the reason we have not included them.

THE CHAIRMAN: They would not promote their funds in the same way at all?

MR. CHIPPINDALE: Not in the same way, but in a different way. They do not have, for instance, salesmen. Some of the mutual fund organizations operate exclusively through investment dealers and others have their own direct selling organizations.

In both cases the shares are offered to the investing public by means of salesmen.

The trust companies do not do that. They so far have run big advertisements and invite subscriptions in that manner. It is not the same kind of business, if you will, as we in this Association are composed of.

MR. STEWART: Then at the bottom of page 7 you refer to certain unincorporated fixed trusts. Could you tell us briefly what type of animal that is.

MR. CHIPPINDALE: That is the type of animal that I described originally, the mutual trust. May I just make a statement, Mr. Stewart, in this connection?

MR. STEWART: Please do.

MR. CHIPPINDALE: We do not attempt to guarantee these figures. We did our best to assemble them. They are very difficult to get, because all this information is not published. We did our level best to try to give the Commission a picture of all kinds of companies that are here. We do not guarantee them. Our own figures we know. These figures we got from all kinds of sources. There is no standard publication that I know of where you can get this information. We have pieced it together from various sources. We think it is pretty reliable.

THE CHAIRMAN: We are very grateful to you. It is the first information, as far as I am aware, that we have received on the general composition of this business.

MR. CHIPPINDALE: We hope it will prove

helpful to you, but you will understand that it is an approximation.

THE CHAIRMAN: Thank you.

MR. STEWART: Mr. Chippindale, if I could go back to page 2 of your submission, at the bottom of paragraph 1 you refer to the acquisition or sales charge which open-end mutual funds make.

MR. CHIPPINDALE: Yes.

MR. STEWART: Could you indicate to us the general range of these charges in Canada at the present time?

MR. CHIPPINDALE: They range generally from a sales premium of 8-2/3 per cent of the offering price down to as low as 1 per cent on volume amounts.

MR. STEWART: Does the charge made vary according to the amount invested?

MR. CHIPPENDALE: It does vary. There is a sliding scale. The charge ranges from 8 2/3 per cent for the smaller amount down to as low as one per cent for large amounts.

MR. STEWART: Can you tell us what size of investment is in the price range which pays the 8 2/3 per cent load?

MR. CHIPPENDALE: That varies by groups and by companies but some start breaking the top sales premium -- the acquisition charge is as low as $5,000. Others do not break it until a higher amount.

MR. STEWART: Well now, as far as this charge is concerned, would the amount of that charge be brought into income of the funds for tax purposes?

MR. CHIPPENDALE: No, the acquisition charge is a fee paid to cover the cost of distribution. The investment fund itself receives only the net amount. The investment fund itself issues the shares upon payment to it by the underwriter of the asset value prevailing at that time, net; the underwriter adds the distribution premium. It is an acquisition cost and when the shareholder -- when the purchaser becomes a shareholder he pays the acquisition cost. When he sells automatically he gets the price that approximates the liquidated value prevailing at the time he disposes of it.

MR. STEWART: So the acquisition premium

covers his total cost of buying and selling and none of the premium is received by the fund.

MR. CHIPPENDALE: No sir.

COMMISSIONER GRANT: In effect, t ere is no charge on selling. It is only on paying.

MR. CHIPPENDALE: It is an acquisition cost. It is just like joining a club or joining a group. You pay a fee. You amortize that over a reasonable period of time. I know of no fund, for instance, that encourages short term buying of mutual funds. This is essentially a long term project. You pay whatever acquisition premium is indicated by the amount of your purchase and then when you go out you get that asset value. That covers its total amount because if somebody wants to sell on the full premium -- let us say he paid 8 2/3 per cent -- he holds that for five or ten or fifteen years, and if he amortizes that acquisition premium over a long period of time it is very small compared with the alternative. If anybody acquires anything or disposes of it, that cost then covers the total round trip buying and selling cost. It is far more apparent than it is real compared with the alternative because all alternative forms of investment costs money to buy and sell, usually far more than generally appreciated.

MR. STEWART: These acquisition costs then go to the underwriter. I take it that those funds retain an investment adviser.

MR. CHIPPENDALE: Yes sir.

MR. STEWART: Can you tell us whether there are normal charges payable to investment buyers and if so what they are?

MR. CHIPPENDALE: Let me say this: On a continental basis, the U.S. and Canada I would say the standard charge has been one-half of one per cent of the average net value of the assets computed quarterly. That is the standard. There are variations from that. Some funds charge less. There have been a few that charge more but one-half of one per cent has been laid down as a standard charge.

MR. STEWART: Is this charge allowed to the fund as a deductible expense in the computation of income?

MR. CHIPPENDALE: It is but it has to be prorated. The fund prorates its income as between taxable and non-taxable income. It is required to prorate expenses, including the managerial fees.

THE CHAIRMAN: I had the idea that these investment counsel funds were divided as between capital gains and income so they were only half allowed as a deduction.

MR. CHIPPENDALE: That is not correct, sir.

MR. STEWART: Now, observe on page 6 your figures that refer to the aggregate market values of domestic mutual funds in 1963, it would appear that the average investment in these Canadian funds at that date amounted to just over

$3,000.

MR. CHIPPENDALE: We have it at the top of the page where we say it amounts to slightly over $3,000.

MR. STEWART: Now, does it follow from that that the appeal of these funds is essentially to the small investor?

MR. CHIPPENDALE: Certainly the majority of the shareholders are what would commonly be referred to as the small investor. On the other hand there are some very sharp investors. There are several who have more than $1 million in these funds, but they are few in number, obviously. Generally speaking, I believe these figures show we have 300,000 shareholders with $9 million in assets which is an average of $3,000, but the average of $3,000 is high because there are a few rather large shareholders. If these large shareholders were not in there, it would not affect the number of shareholders very much; it would affect the amount per shareholder. It would be smaller than $3,000.

MR. STEWART: Have you any idea, Mr. Chippendale, as to the income group in which your average investor would fall?

MR. CHIPPENDALE: Sir, I just don't have any idea of that. There never have been any figures gathered or published that I know of in that area.

MR. PETERSON: Well, speaking from our own experience, I would say that the great majority,

that is over 50 per cent, would be in the income bracket from $6,000 to $10,000 to $12,000.

MR. STEWART: Thank you. Well now, would the average figure hold or be likely to hold for individual funds whether the funds themselves are large or small? I am not sure I have made my question clear. But I have in mind ---

MR. CHIPPENDALE: I anticipate your question. It varies by the fund. Some funds have a slightly higher average. Some have a slightly lower average. To some extent it depends on their age, their length of operation, the type of operation. For instance, the funds that operate through dealers would have a slightly higher average of shareholders holdings than those that have their own direct selling organizations, because with a direct selling organization they can get out and seek the people out and they cover the people more thoroughly than the average investment dealer, who has more or less a clientele.

An investment dealer's clientele is apt to be -- I am just talking over the top of my head -- composed of people with slightly higher income. The fact they are a customer of an investment dealer in itself indicates they are higher than the lowest level of income people; whereas in a direct selling organization they can get right out to the grass roots. I would like to make an observation there. I personally feel that this is the only type of savings institution in Canada that can and does on

an economical basis provide a sound service and enable a salesman to go out and gather the savings of small people. That is essentially what its function is accomplishing. We have other savings institutions and the stock exchange, for which I have great respect and they are certainly essential to the nation's operation, but they cannot economically, the members of the Stock Exchange, go out and spend a lot of time finding people who can only save $200, $300 a year, but it is the masses of these people.

In addition to the fact they can do that, it is also one of the very soundest ways for them to invest from an investment standpoint because all these funds have a cross section of what are regarded to be among the finest securities in the country made available to these people for their savings.

MR. STEWART: Mr. Chippendale, if I could go back for a moment to this question of average investment. You have indicated that there will be variations from the $3,000 average from fund to fund, but do I take it that the variations will not be very substantial; that the average member of most of the funds would have an investment of about the $3,000 range.

MR. CHIPPENDALE: Well, I would say that -- this is speaking off-hand again -- I would say that perhaps the top average would be close to $4,000. That is true, I think, in the case of my own company. The others would get down perhaps closer to $2,000

level and it depends to some extent on how thorough a job they are doing in reaching the grass roots money investors.

MR. PETERSON: I would like to make one point. A number of the funds -- and this would reach at least 60 per cent or more, make plans available to individuals on a serial basis. They can start with as low as $50. They embark upon a program over a period of years. Sometimes they contribute quarterly or half-yearly, and sometimes when it is convenient. Others do not always follow through. I think that is a service that is very important in the distribution of this service.

MR. CHIPPENDALE: At this junction I would like to enlarge upon a previous statement that I made when you asked me about the acquisition cost. I said they had a top rate of 8 2/3 per cent. That is true for a normal purchase, but the plans to which Mr. Peterson referred which involves these very small amounts, a total cost there can run higher than 8 2/3 per cent. Not all funds offer this type of plan, but the funds that do, the charge necessarily has to run higher than 8 2/3 per cent to cover the handling cost of the small monthly payments and the small amounts involved.

MR. STEWART: When Mr. Peterson referred to a serial plan, is this sometimes called instalment purchasing?

MR. CHIPPENDALE: Yes.

THE CHAIRMAN: Mr. Reid has something he wanted to say.

MR. REID: Mr. Chairman, I would like to give you some statistics so far as my own company is concerned. We have what we call a compound cumulative fund which is sold mainly for capital accumulating objectives. Many small investors, particularly young people, like this type of fund where they do not withdraw income but allow it to be plowed back to increase their equity over a long period of time. The average shareholder in a mutual cumulating fund will do this. We have some very substantial holders in the form of pension plans and individual large holders. Some may hold $500,000 to $750,000 but the average, excluding these, would bring the figures to less than $1,000, if you exclude distributed income and the average shareholder in that shareholding whose intention it is to save may, for a long period of time, tend to be the smaller shareholders. Those whose intentions are for investment and earning dividends tend to be the larger shareholders.

THE CHAIRMAN: Thank you.

COMMISSIONER GRANT: Would you identify your fund, Mr. Reid, on Exhibit B, page 51 and 52, which is the fund on which you lay the capital depreciation emphasis.

MR. REID: We have two in that category. One is a mutual accumulating fund which has its base mainly on common stock, and the second is a mutual bond fund which has its base in debt

securities. This is on page 52.

You will notice also that included here are mututal income fund and mutual bond income fund. These are sharing in the same portfolio but they have a different function of distributing dividends quarterly. We also have a periodic scheme and plan which is available to the shareholders at a standard maximum load, 8½ per cent, so there is variation in sales charges, according to the different companies.

It is very hard to take an average. I think probably Mr. Chippendale gave you the average for the industry, but there are quite wide variations in the individual companies. Each one has to cut its cloth to fit its own objective.

MR. CHIPPENDALE: Mr. Stewart, may I just make an observation. I think you asked if this was known as instalment payments?

MR. STEWART: Yes, instalment purchasing.

MR. CHIPPENDALE: I would like to make a correction. These are periodic purchases. In the industry, instalment purchases would be where you make one lump sum purchase and pay it off in instalments, which would be the equivalent of buying on margin. These are simply periodic deposits and these deposits are utilized to buy outright whatever amount of the underwriter's securities may be tought with them. It does not involve any leverage.

MR. STEWART: I take it from what you have already said your Association would consider

some portion at any rate of this billion dollars to which you refer, would not have been invested in securities if the Mutual Funds did not exist.

MR. CHIPPENDALE: I feel very strongly that is the case.

MR. STEWART: You are familiar, I have no doubt, with a study of mutual funds which was prepared for the S.E. Wharton School of Finance and Commerce in 1952.

MR. CHIPPENDALE: Yes sir.

MR. STEWART: I have a copy of their report in front of me. I would like to read this statement from page 21 where they are discussing the growth of mutual funds in the United States. They say this:

> " Much of this money might have been invested directly in the stock market even in the absence of mutual funds, but a substantial proportion probably would not have been invested in the market either directly or indirectly without the growth of mutual funds and their successful tapping of savings courses not traditionally channelled into the stock market."

Would you consider that that statement would also be true in Canada?

MR. CHIPPENDALE: Well, the only question might be of degree. The general principles, yes. There is no question but that some part of

that money would have gone into stocks, but in the main, in my personal opinion, it would not be very much.

I hate to go back and keep adding to things I have said, but I think it might be useful to point out that there are several different ways, as Mr. Reid has indicated, you can purchase these shares and not every company has the same plan. Some companies have a different company. Others just have a plan within the company. They provide essentially the same service. There is one big feature. These periodic purchase plans we have already referred to are in two categories. Those which are called voluntary plans which require no contractual commitment, and which may be terminated any time without penalty and which carry the normal acquisition costs. The other type of periodical purchase plan is concerned with a contractual plan where the total charges run a little higher because the services involved are somewhat different. They involve a contractual commitment and if carried through to the commitment of the contract they suffer no penalty. If they do not carry through, on a sliding scale they would have to make some sacrifice in their liquidated values.

Those, in principle, are the different methods. Then you have the outright purchases; you have plans for automatic reinvestment of dividends, and things of that kind which are general in all companies. All companies do not have a contractual plan. All companies do not have a voluntary plan. Some have one, some have the other; some may have both.

MR. STEWART: Could you tell me how the Canadian mutual funds are divided as between common stock funds and balanced funds, and whether there are any other major classifications of these funds?

MR. CHIPPINDALE: If I might say this -- and my colleagues here may disagree with me -- I think that it is fair to say in Canada that by far the greatest majority of the funds are primarily common stock funds. To my knowledge there is only one bond fund, and that is very small. They try to state a degree of emphasis. One might call it a growth fund, to invest primarily in common stocks. Somebody else might use the term a "balanced fund", but it is to invest primarily in common stocks.

I think there is a very decided similarity in the great majority of all Canadian funds as distinct from the U.S. In the U.S., where you have such a much bigger financial economy, where you have much greater numbers of investors of all classes and all kinds and varieties of securities, they do have down there what are known as balanced funds. The charters of those funds have rigid percentages which cannot be exceeded in the area of stock, whether common stock,

preferred stock or bonds. They have some flexibility and the management can vary them within limited percentages. But at all times they must be rigidly within those three classes of securities.

We do not have a fund of that type in Canada.

MR. STEWART: Then you would perhaps be involved in some problem here of the definition of terms. If we have a fund which, let us say, is invested 60 per cent in common stocks and 40 per cent in reserves of one kind or another, do you regard that as common stock fund or a balanced fund?

MR. CHIPPINDALE: Offhand I cannot think of one. If it is over one-half in common stocks it is primarily a common stock fund. We have taxation, of course, which importantly influences the proportions of the investments which are going to be held by the various companies.

MR. STEWART: I will come to that, but let me ask you this. The typical Canadian fund -- well, perhaps there is no typical Canadian fund, but you say that you regard Canadian funds as primarily or predominantly common stock funds. What would the range of reserves be in Canadian funds?

MR. CHIPPINDALE: When you say reserves, you mean fixed income tax securities?

MR. STEWART: I am thinking of cash and fixed income type, both of preferred stocks and bonds.

MR. CHIPPINDALE: That is what we call fixed income type, whether preferred stocks or bonds and cash. They will vary according to the judgment of the management

of each fund. Also, they will vary in accordance with what the representations have been to the purchasers. You cannot go out and invite subscriptions to a fund and tell the purchaser that you consider yourselves to be a conservative fund and you show a portfolio which has a 20 per cent defensive position. I hardly think that you could live up to your representations to a purchaser if all of a sudden you did not have any defensive position. But the amount can vary in accordance with the best judgment of the management as to the outlook and the stated purpose of the fund, and they will vary, I would say, from 30 per cent down.

MR. STEWART: When you say down, you mean ---

MR. CHIPPINDALE: Smaller. A maximum of 30 per cent defensive position -- that is our loose terminology -- down to practically nothing.

MR. STEWART: Then the defensive portion would be divided broadly in these three groups of cash, preferred stocks and bonds or short term paper?

MR. CHIPPINDALE: Yes.

MR. STEWART: In Section 69 of the Income Tax Act, Mr. Chippindale, it is provided that not more than 25 per cent of the income of these funds can be from interest.

MR. CHIPPINDALE: That is correct.

MR. STEWART: Do you consider that that limitation is appropriate and that it permits these funds to follow a desirable investment policy?

MR. CHIPPINDALE: Personally, I do.

MR. STEWART: So that if the defensive or

reserve component of a particular portfolio were to extend to 30 per cent, some substantial portion of the 30 per cent would have to be in preferred stocks?

MR. CHIPPINDALE: Right. That is in order to qualify for that section.

MR. STEWART: Yes. You do not think that in practice this creates any problem?

MR. CHIPPINDALE: I can say this, that it has not in the case of our company so far.

MR. REID: May I just make an observation there, Mr. Chairman. Each company or group of funds is likely to have some individual attitude which differs from other groups of companies. May I speak in connection with my company. We have set our funds up as investment trusts. Because of the latitude provided provided management to deal with the securities in keeping with conditions which exist in the securities market, we have no hindrance in any respect in investment decisions. We can be 100 per cent defensive if we feel that it is in the shareholders best interest to be so, without any tax disadvantage to our certificate holders or shareholders.

THE CHAIRMAN: You are unincorporated, are you?

MR. REID: Yes, we are unincorporated. This is of extreme help to investment management. We are not hampered by rules or regulations which the Companies Act may bring about, or which the Income Tax Act may bring about, simply because we are conduits, and the fund is owned 100 per cent by its shareholders

or certificate holders, and all the income is flowed through to them in the exact identity that it is earned. Bond interest is passed along to the shareholders in proportion, common stock dividends, preferred dividends if we hold any, so that each individual shareholder benefits in the portfolio in accordance with his proportion of shares related to the total, in the same sense as if he held the individual securities himself directly.

So that when Mr. Chippindale says that the 25 per cent limitation in defensive securities has not interfered with his company's investment moves, I should not like to say that if we had an incorporated fund -- and we have one called Beaubran Corporation -- we could not save this for ourselves, because there may be a time when it would be in the shareholders best interest to defend the portfolio, perhaps to 50 per cent or 60 per cent, and we would not like to feel that it was going to be also a disadvantage to the shareholders taxwise.

MR. CHIPPINDALE: May I just make a comment on that, please. I wonder whether it is correct, Alec, to say that in your form of company. That is the type of treatment we are all claiming, that of being treated as a conduit, but I wonder whether it is accurate to say that taxes are not a consideration in your investment policy. If all your money was invested in Canadian company stocks you would get a 20 per cent dividend, but if it was in bonds you would get nothing.

MR. REID: That is correct.

MR. STEWART: I did not understand Mr. Reid to say that. I understood him to say that what he was saying essentially was that in certain circumstances a 25 or 30 per cent limitation on the reserve component of a portfolio might not be high enough.

MR. REID: It might be to the disadvantage of the shareholders. As stewards of the assets we must al ways consider the best interests of the shareholders.

MR. PETERSON: In our case we feel that we can live with the 25 per cent limitation. On the other hand, we should like tofeel that investment management will not have to consider tax implications as against investment management, and this can happen under certain conditions.

MR. CHIPPINDALE: That is right. Under the present situation of an incorporated fund, if you did not comply with the 25 per cent requirement you become taxable as a regular corporation, and it would be critical as a consideration. Whereas if we were granted our request here to be treated as a conduit, you would not be completely free of tax considerations and implications. All you would be doing would be to make the greater part of your income subject or not subject to tax credits, but it would still be a consideration. It would not be critical.

THE CHAIRMAN: It would put the individual in the position as though you were not there.

MR. CHIPPINDALE: That is correct.

THE CHAIRMAN: We recognize that there are tax

advantages and disadvantages to the individual by investment, but because you put your money into the market through your organization it would not affect the investment choice beyond the way that you would have been affected had you done it yourself.

MR. STEWART: Is there anything corresponding to this 25 per cent interest limitation in the United States?

MR. PETERSON: Not to my knowledge.

MR. CHIPPINDALE: There is a qualification down there that registered investment companies require to be registered under the Investment Company Act of 1940. They have that kind of qualification which makes it readily applicable to everyone. They have certain limitations or requirements for meeting the position of being completely tax free.

MR. STEWART: Of course they have. They have limitations as to the diversification of interest, and they have limitation as to the distribution of income. But have they any further limitations?

MR. CHIPPINDALE: I think they have a limitation and still say that a certain proportion of your income has to be derived from common stocks, for example. I would not want to state that as definite, but at one time that was the case.

MR. PETERSON: I happen to be on the board of a company in the States, and I do not think this is the case. I am not aware of it.

MR. CHIPPINDALE: Years ago I remember making representations to the government here, and I based my

requests at that time on the United States practice, and that was that so long as 70 per cent of your income was derived from dividends from stocks, you would consider that to be a non-taxable entity. It did not have to be 90 per cent or 95 per cent so long as it was 70 per cent. But if you did not have 70 per cent you fell into a different category.

That was some years ago. Whether it has changed I cannot say, but it was a factor at one time. I tried to persuade the authorities here to look upon the main purpose and not to be confused by the ancillary results, and if in the main they were receiving 70 per cent or more on their dividends from Canadian taxable corporations, that was their main objective -- the other things were incidental -- and they should be treated as a tax free vehicle, which was the case in 1946. They were exempted from the Income Tax Act in 1946. We became subject to tax again when the dividend tax credit was introduced, if I remember correctly, in 1949, first at the 10 per cent level and then at the 20 per cent level. It did not apply to our dividends because we were exempted from the Act.

MR. STEWART: Can I leave this point on this basis, that if you would not mind perhaps you would check it and let the Commission know through the Secretary whether there is any such limitation in the United States.

Now, is it not the fact that at the present time the recognized indeces of common stocks in North America are selling at or close to all time highs, and

that if there is or there will be a need for an increased reserve position, a limitation of this character may have unfortunate effects on the industry?

MR. CHIPPINDALE: What we are asking for in this brief to be recommended is that we be treated as a conduit. If we were this factor would disappear and would not be a consideration. It would then just be a question of investing funds as you felt you could from a purely investment management standpoint and in accordance with what you indicated to the purchasers that they were buying. You cannot go out and solicit money from a man on the street and tell him: "You have most of your money in fixed asset securities; why don't you buy some common stocks which might keep you ahead of inflation", and then you turn around and make a fixed income consideration out of it. The other alternative would be to defend your position if you wanted to. I will not say what I was going to say. The only impact would be to change the degree of the tax credits to the owner of this conduit. You would not make yourselfliable to a complete changeover, as is the case in this act.

MR. STEWART: In your proposal 2 I think you still retain the 25 per cent limitation.

MR. CHIPPINDALE: I beg your pardon?

MR. STEWART: In your proposal No. 2 you retain the 25 per cent limitation?

MR. CHIPPINDALE: If you will permit me I will have to refresh my memory.

MR. STEWART: I am referring to page 46. At

the bottom of page 46 you are dealing with unincorporated, and at the top of page 47 you are dealing with incorporated ones. You appear to contemplate in the first sentence of paragraph 82 that the 25 per cent gross revenue from interest provision would still apply.

THE CHAIRMAN: That is to compensate for the fact that they get the dividend quite irrespective of the diversity of the investments. Is that right?

MR. CHIPPINDALE: Fundamentally I think the government put that restriction in that you could not claim more than a certain amount of your income from interest sources because they are allowing tax credits to flow through this funnel, and they are making a lot of reasonable allowances to maintain a defensive position. But it may be possible to carry a 20 per cent dividend tax credit on the entire amount of the dividend paid by the company to its investor shareholders. If it is only going to be paying out interest there is no tax credit on interest. That is a fundamental principle. But they are making a reasonable allowance here while maintaining the principle of a dividend tax credit.

MR. STEWART: We are trying to explore at the moment, Mr. Chippindale, the desirability of the present rules from the point of view of the people who invest in your funds. What I am trying to get at at the moment is whether this 25 per cent limitation over the average small investor in a mutual fund is a good limitation.

MR. CHIPPINDALE: I think I have answered that. We have found it so in the operation of our company, but there could be differences of opinion on that.

MR. STEWART: Then could we move to page 13 of your brief, paragraph 17. There you set out certain figures with regard to common stock investment, and I should like to refer to two of them. You say that at December 31, 1961, the investment in Canadian common stocks was $465 million odd, and if I go back to page 6 I see that on that date your assets had a market value of $746 million.

MR. CHIPPINDALE: Yes.

MR. STEWART: I have made a rough calculation, and it seems to me that the common stock component of that $746 million was 62 per cent approximately.

MR. CHIPPINDALE: On the basis of the figures on page 6?

MR. STEWART: Yes.

MR. CHIPPINDALE: Yes, 62 per cent.

MR. STEWART: I observe on page 13 that at June 30, 1963, your common stock investment was $587 million, and from page 6 I observe that at that time your funds had a market value of $938 million. This, again, seems to be approximately 62 per cent.

MR. CHIPPINDALE: Yes.

MR. STEWART: So that on common stocks as percentages of the total market you appear to be reasonably constant on those two dates. Have you any figures relating to the non-Canadian common stock holdings on any of these dates? Have you figures as to the foreign common stocks, other equities, Canadian bonds, foreign bonds, cash and so on?

MR. CHIPPINDALE: I have not those figures available with me, sir. By deduction, of course, everything that is not in Canadian common stocks is in Canadian preferred stocks, foreign stocks and bonds.

MR. STEWART: When you were required, in order to continue to qualify under Section 69, to achieve an 85 per cent Canadian content, was it necessary for your funds to sell substantial foreign equities?

MR. CHIPPINDALE: I can only speak for my own fund. Because of an unusual distribution by a big company in the United States of stock in another company as a taxable dividend, we found it necessary to sell a modest amount of stocks so as not to get that dividend, yes.

MR. STEWART: There are no figures ---

MR. CHIPPINDALE: We did not consider it to be any particular burden.

MR. STEWART: There are no figures which would indicate whether the industry as a whole had to sell foreign stocks in order to qualify?

MR. PETERSON: In my opinion, I think there would be some.

MR. CHIPPINDALE: There are no figures to indicate that. There may have been others, but no figures are available. I would not have considered that to be of vital concern. That was my impression.

May I make an observation on that?

MR. STEWART: Yes.

MR. CHIPPINDALE: It is only the incorporated fund that we are concerned with. The 85 per cent provision at present does not apply to the unincorporated funds.

MR. STEWART: I am well aware of that. I would now like to move to page 14, Mr. Chippindale, where at the end of paragraph 18 you say that your funds become more defensive in their investment choices in periods of high markets which is a further stabilizing market factor.

MR. CHIPPINDALE: That is correct.

MR. STEWART: When we talk about stabilizing factors in the market I would like to be sure that I understand what you mean. Is it broadly this, that your funds would tend to sell equities if the market gets too high, and that they would tend to come back into the equity market if they considered the market was getting unduly low?

MR. CHIPPINDALE: There are several different

means by which you can increase or decrease a defensive position in an open-end mutual fund. To begin with, you have new money coming in all the time, and if you want to become more defensive, all you have to do is hold the incoming cash in the form of cash or fixed securities and that in itself increases your defensive position and reduces your common stock holdings.

There are also means other than just buying bonds. Stocks have all kinds of gradations individually -- one or the other in their nature -- in the degree of speculation or investment. Let us take Bell Telephone, for instance. That is a highly defensive individual security. Thereforea fund might easily say, "We are going to sell a steel stock", which might be highly cyclical, "in order to become more defensive, and put it into a utility stock like Bell Telephone". They can achieve it that way.

It does not necessarily mean that you sell or buy anything. There are all kinds of means by which these things can be accomplished and are accomplished. For many, many years I cannot remember where we -- I do not want to say "ever", but very seldom ever had to sell stock to reduce our holding in it. We just quit buying it. In the case of an open-end fund it is easier with new money coming in. If you do not buy them, you are automatically reducing your holding, proportionate to the total assets.

MR. STEWART: I would like to read another extract from this Wharton Report, which is also from page 21 and has to do with the general question of

stabilization through mutual fund activity:

"In connection with the stabilizing or destabilizing behaviour of mutual funds on the market -- that is, the extent to which the timing and pattern of their trading moderated or accentuated short-term price fluctuations, the relatively stable inflow of money into these funds and their extensive use of limit orders, particularly by the largest funds, may be considered to exercise some stabilizing influence.

Thus their day-to-day and intraday net purchases do show some tendency to counter the immediately preceding and concurrent short-term price trends, but there is no consistent relation of these net purchases to month-to-month price trends. The funds showed some tendency to trade with, rather than against, the trend in cyclical movements of stock prices, and this destabilizing behaviour seems to reflect discretionary action rather

than the automatic channeling of net inflow into the market. At turning points, the discretionary action of the funds -- except perhaps for the largest funds -- tended to stabilize at the lows and destabilize at the highs of the market."

I might also read a sentence from page 23 of this report:

"It is not possible to characterize the trading behaviour of mutual funds in response to prior to concurrent fluctuations in stock prices as preponderantly stabilizing or destabilizing, though there is some evidence of a destabilizing influence in price declines prior to the lows".

Would you regard those comments of the Wharton School of Finance and Commerce as appropriate to Canada?

MR. CHIPPINDALE: No, sir, I would not. Those are matters of opinion, of course, and I think I can show facts that would disprove them.

MR. STEWART: On page 19 ---

MR. CHIPPINDALE: Mr. Stewart, would you permit me just to elaborate on that slightly?

MR. STEWART: Yes.

MR. CHIPPINDALE: I happen to have a case example on page 17 which has a bearing on what you asked me just now.

That was in 1962, when the stock market both in the United States and Canada had probably one of the greatest declines in the reported history of the stock markets of that given period of time. This is not an opinion; this is a fact.

In the case of my own company -- and I am sure it must have been true of others -- before the end of 1961 we felt that the market was a little high and we proceeded to increase our defensive position to the tune, let me say, of maybe $1½ million in cash together with other defensive securities.

MR. STEWART: That was very wise.

MR. CHIPPINDALE: And that, I say, was a stabilizing factor in the market at the time. We were not the type of investors who would just buy them because they were high. We were selling them and increasing our defensive position because we thought they were too high. That is what I mean by a stabilizing factor in the market. We were not pushing it higher. If anything, we were tending to hold it down a little bit.

MR. STEWART: May I just interject there. At the time you speak of, what was the aggregate market value of your fund?

MR. CHIPPINDALE: Of my fund?

MR. STEWART: Yes.

MR. CHIPPINDALE: I cannot remember offhand --

value changes every day -- but somewhere in the neighbourhood of $140 million before the decline, and of course it declined when the market went down; it shrank.

MR. STEWART: If you made sales of $1½ million you would increase your defensive position by about one per cent of the fund?

MR. CHIPPINDALE: We made sales of $1½ million. We already had a good defensive position because we had been worried about the position of the market before that. Our defensive position was about 20 per cent of the $140 million, or $20 million in cash and government securities.

MR. STEWART: Is it the fact tht by selling $1½ million you would increase the defensive element by one per cent?

MR. CHIPPINDALE: That is correct; and that has a stabilizing effect on the Canadian market. $1½ million of stock on the Canadian market has a stabilizing effect on the Canadian market. I would like to finish my story while we are on this.

MR. STEWART: Please do.

MR. CHIPPINDALE: When this break occurred in 1962 to which I referred, after the advance got well along we were able, as a result of having taken a more defensive position and having exercised stability in the market at the top, to go in and provide a market at a time when it was in a critical price situation and there were not many buyers around at that time.

This is not theory. I was there doing it myself, and it certainly made a very valuable contribution to the liquidity of the Canadian stock markets and they would have been hit much harder than that if we and others like us had not been willing buyers when people were getting panic stricken.

That is what I meant when I advanced the suggestion that these companies have a stabilizing effect in the market. They are value conscious.

MR. STEWART: I do not know whether it is appropriate at this point to refer to page 19, but at the top of page 19 you refer to one fund which bought over $6 million of Canadian common stocks during the period of that short market break.

MR. CHIPPINDALE: That is right.

MR. STEWART: Could you tell me what percentage of the assets of that fund $6 million represented?

MR. CHIPPINDALE: At that time it was about $130 million. What would that be?

MR. STEWART: Between four and five per cent.

MR. CHIPPINDALE: Between four and five per cent. That may not be too material relative to the size of our fund, but it was very material to the stock markets of Canada at that time, because nobody was buying, to speak of.

MR. STEWART: As it turns out, it was very material to your shareholders?

MR. CHIPPINDALE: It turned out to be very good buying. But that, I suggest, is a concrete

example in answering your question as opposed to what the Wharton School said, which I disagree with as applying to Canada.

MR. STEWART: I think you would concede that this study of the Wharton School is a very exhaustive and painstaking survey of mutual funds in the United States, would you not?

MR. CHIPPINDALE: I do not want to get into a controversy about this, but I would say that some of us have far more experience in this business than the authors of that report.

MR. STEWART: Is it not the fact that the report is based, to a very considerable extent, on information received from between 150 and 200 practicing firms in the United States?

MR. CHIPPINDALE: That is right, but it is written by people who are not experienced in the business.

MR. STEWART: During, let us say, the last ten years in Canada has there been a period in which redemptions of mutual fund shares substantially exceeded new purchases?

MR. CHIPPINDALE: Not to my knowledge. If so, it would have been for an extremely short period. It has been the experience of my company -- which I have operated for thirty-one years and we have gone through the biggest world war in history, depressions, and all kinds of economic fluctuations -- (1) that we never had to sell an underlying portfolio security to make a redemption; (2) the history of our fund is that

shares increase, people become more willing to buy and do buy more in periods of market adversity than they do in buoyant markets. Apparently in buoyant markets people get impressed by the fact that probably they can get rich quicker. You certainly cannot get rich quicker than in a mutual fund. In other words, they want something on balance that will give action. When you come to market declines, we have not experienced substantial net redemptions in those periods. In fact, we have found an increased buying interest in the buyers of our fund in those periods. That has been our experience.

MR. PETERSON: May I just elaborate on that, Mr. Stewart. In my own case, we have three mutual funds and represent something in excess of 40 per cent of the assets of this industry, and our redemptions have been highest on rising markets and lower when the market is declining. But there has never been a period when we have had to sell any security or liquidate to meet redemptions, and the sales have always exceeded redemptions.

MR. STEWART: Has there not been some concern in the financial security generally, Mr. Peterson, that if the small investors in the mutual fund were to lose confidence in the market or in the long term prospects at the time of a sharp break such as occurred in 1962, and proceeded to redeem their shares in quantities, that far from having a stabilizing effect on the market, the mutual funds might have, through forced sales in order to meet redemptions, a very

adverse effect on the market?

MR. PETERSON: Obviously, if all the shareholders wanted to redeem, this would be so; but as a practical matter it does not work out that way. It has never happened.

MR. CHIPPINDALE: Just the opposite.

MR. REID: May I make one observation on this point, Mr. Stewart?

MR. STEWART: Yes.

MR. REID: On the worst day of the 1962 crisis we were rather heartened to find that there was not one single share redeemed. This is significant. It is the experience, I believe, of most of the funds in the industry that practically all redemptions have dried up during difficult periods. But, as Mr. Peterson observed, redemptions tend to increase when the markets are high, and decrease when the markets are unstable.

MR. PETERSON: There is one further point I would like to put on record, that in Canada there are no leverage funds being offered at the present time. This is a very important factor. People have common stocks on margin, and when you have a decline they naturally become panicky. But they own these shares outright. In the case of a contractual plan, you might call it, the monies have been funnelled into the company and they are used to buy securities outright.

MR. CHIPPINDALE: If I may interject, I am perfectly aware that there are many articles that have been written on that very subject. I used to have said

to me: "What will happen if some day all of your shareholders come in and want their money?" I said, "About the same thing that would happen if all the depositors in any bank went in and wanted their money. The same thing that would happen if all the policyholders of any insurance company died all at one time". The fact of the matter is, they do not do it.

MR. STEWART: Now I would like to turn to the section of your brief which commences at page 29 and ask you one or two questions with regard to the 85 per cent Canadian content clause of section 69.

On page 32 of your brief you suggest that during the period from June 30, 1960 to June 30, 1963 Canadian stocks have outperformed United States and British stocks. Isn't that correct?

MR. CHIPPINDALE: That is right.

MR. STEWART: I imagine, Mr. Chippindale, that you know a firm in Toronto called Laidlaw and Company?

MR. CHIPPINDALE: They are a U.S. firm primarily. They have a branch in Toronto.

MR. STEWART: I should like to show you a table which has been prepared by Laidlaw and Company at my request which shows movements in the averages since 1945. The portion of this which is interesting, I think, is the portion at the bottom of the page, where they compare, first of all, movements in the Dow Jones industrial average and the Toronto Stock Exchange old industrial average during certain periods. Then they also compare the performance during those periods of the Standard and Poors industrial index and the new Toronto stock exchange industrial index. The comparison in the latter case only goes back to 1954 because, as you know, the new Toronto index has not been carried back beyond that date.

I observe that in the first period which is dealt with from 1945 to 1963 the Dow Jones has outperformed the Toronto index slightly; but if you take the period 1954 to 1960 the Dow Jones outperformed the old Toronto index somewhat, and Standard and Poors outperformed the new Toronto index quite materially.

You will also see that from the end of 1960 to the middle of 1963 the old Toronto index outperformed the Dow, and the new one outperformed Standard and Poors, and that if we take a period from the end of 1954 to the middle of 1963 the Dow outperformed Toronto, and Standard and Poors outperformed the new Toronto index.

Would these figures seem likely to you to be correct, Mr. Chippindale?

MR. CHIPPINDALE: I am not in a position to doubt their accuracy, but I should like to read paragraph 40 on page 31 of the brief, Mr. Stewart. That paragraph says:

> "Periods can be selected when foreign stocks outperformed Canadian stocks as well as vice versa".

However, a good deal was heard about three years ago -- that is, June 30, 1960, which was a low point in the market -- condemning on a widespread basis investment opportunities in Canada and extolling the virtues, if you will, of the greater opportunities in other countries. That is the reason that those figures are in for that period.

I remember this very well. It shows that that proved to be wrong.

Let me just make this observation. Prior to World War II Canadian stock markets were much smaller. The numbers of shares in various stocks were smaller. We had a pretty large non-resident interest in our stocks because of the glowing future for our country.

It was common in those days for any Canadian common stock of a quality comparable, for instance, to the United States counterpart to sell on a much higher earnings times price ratio. As an example, the old C.I.L., which was jointly owned primarily by Du Pont and I.C.I., could be compared with Du Pont stock. Both are good stocks. C.I.L. used to sell at about twice the price to earnings ratio as did Du Pont. I would concede that perhaps they are of equal value, but the point was that there was at that time a large scarcity value in the Canadian market relative to the investment demand, domestically and foreign.

Now, somewhere along the line, as Canadian common stock became more abundant -- and they have because I have figures here which show that net new issues alone have amounted to $336 million per annum for the last eight years, which is a sizeable sum of money in a country of this size.

In addition to that, we have made large net repatriations from foreign owners of our stocks. Last year and this year that occurred, running well over $100 million both years. The scarcity value in our market disappeared some time during the war or the early post-war years, to the point where I have figures here showing -- I did not select the stocks direct from the Toronto Stock Exchange, the industrial index, it is somebody else's selection. I have taken them from the Dow Jones industrial average. We took their closing prices on August 14th, just before the brief was filed, and divided them by the number of

securities on the list. We took the latest 12 months earnings of those companies in both cases. When I say 12 months I mean not on a calendar year basis but up to the 12 months preceding that date. This is page 33 of the brief.

We figured the price times earnings ratio on that basis. Those stocks in the Toronto area were selling at 16.4 times earnings. Dow Jones was selling at 19.5 times earnings. We did the same thing with dividends paid. The dividends paid in the latest 12 months prior to that date, the average yield of Canadian stock was 3.55 per cent, and the Dow Jones stock was 3.19 per cent.

What I am saying is that if you made this same calculation at any time during the thirties, the arithmetic would have been reversed with a much greater margin. We are more concerned with today and the future than the past, and I think that that indicates, or is one indication, that we have stocks in Canada relative to the demand in Canada, to the point where we are not pushing our prices in the investment of savings in these stocks to levels higher than other countries. In fact, they are not as high as in the United States, which is the opposite of the position prior to the Second World War.

MR. STEWART: If I can go back to the table I have shown you, if we take, let us say, the situation at the end of 1959 where there was a close on the Dow industrial average of 679, and on the Toronto stock exchange index of 530, and if we assume that at

that particular time a Canadian investor had the choice of putting $100.00 into the Dow Jones industrial average on the one hand, and into the Toronto Stock Exchange industrial average on the other, is it not also the fact that between that particular date and the end of June of 1963 the Canadian dollar depreciated from a premium of approximately 5 per cent in relation to the American dollar to a discount of approximately 8 per cent? If those figures with regard to the dollars are approximately correct, would it not be the fact that the person who invested in the American market would have had a further very considerable appreciation during that period of 3½ years in terms of the Canadian dollar?

MR. CHIPPINDALE: I cannot recall the correctness of those figures. The 5 per cent premium on the Canadian dollar was a peak. I do not know whether it happened then or not, but it was not a 5 per cent premium for very long. I do not deny that these figures work out both ways. You are presenting figures to me which work out one way, in just the same way as I am presenting figures which work out the other way. We could go on selecting periods on both sides indefinitely. It can be said that anyone who bought U.S. stocks have suffered a tax penalty. They did not earn the 20 per cent tax credit from foreign purchases. But you can pick out periods like that, I do not deny, and we can go on for a long time picking out this period, that period, and the other period, winding up proving that part of the time one is better

and part of the time the other is better.

The main point here which we are making in the brief is that Canada is a young capital-hungry country. It is felt desirable by a lot of high placed officials and other important people that we should have a greater ownership of Canadian common stocks, and certain tax measures are adopted to try to encourage that position. I am one who has a vested interest, as I think every other Canadian has, in this country and I say that I can pick out periods and show you one thing and another thing. But lately, for example those three years, you would be much better off in the Canadian market. In some other periods you would have been worse off.

MR. STEWART: What I am trying to do is to discuss with you whether or not this 85 per cent Canadian content rule is desirable in the interests of Canadian investors, and I have been attempting to lay a foundation for that.

Now may I continue with one or two preliminary questions. You also point at the top of page 31 that:

> "Canada at this stage does not have as great a variety of equity issues available to investors as does the United States, nor do Canadian stocks generally possess as ready marketability as do stocks of some of the very large companies in the United States."

Is it not a fact that our Canadian institutions have been investing in foreign equities to an increasing extent?

MR. CHIPPINDALE: Certainly not investment companies. I cannot say for the other investing institutions because I do not know. I suppose that you are referring to trust companies or something of the kind.

MR. STEWART: No, I am thinking not only of trust companies but insurance companies and pension funds.

MR. CHIPPINDALE: I think that insurance companies are pretty well guided by their insurance liabilities. I am not sure that they are a free agent in their selection. They have to hold securities in the countries of certain policyholders to a certain amount. What was the other?

MR. STEWART: Pension funds.

MR. CHIPPINDALE: Pension funds which have total assets over $3 billion. One of the largest pools of savings in Canada which have made annual accruals now ranging from five to six hundred million dollars both by way of payments into the plan as well as the income on the $3 billion, in more recent years have been increasing their purchases of common stocks. But they still only hold a minute portion of the total $3 billion in stocks, and I would guess, because they do not publish their portfolios either, that they invest more in Canadian stocks than they do in equities.

MR. STEWART: That is not my question, Mr.

Chippindale. I base this question to some extent on the financial press. There have been articles in the financial press on this subject, that to an increasing extent our Canadian institutions are directing their common stock purchases to the United States.

MR. CHIPPINDALE: Over what period of time?

MR. STEWART: I am talking of a recent development.

MR. CHIPPINDALE: I would think, although I cannot prove it one way or the other, but I am reasonably familiar, I think, with investment patterns and I know a lot of investors in this country of all kinds, that when the Budget brought down that tax factor -- I mean our Canadian Budget -- part of it was later withdrawn -- I am referring to the question of the tax on purchases of Canadian stocks by non-residents, which you remember was last August -- I understand that that did accelerate interest in U.S. stocks. But I have not got the figures, and I doubt whether any one has. Certainly it did not stop people entirely from buying Canadian stocks. That area is still uncertain. I do not think they are serving the best interests of the Canadian economy. I know a lot of people who have bought Canadian stock in that period. It may prove temporary, I do not know.

MR. STEWART: I should like to put this question to you, Mr. Chippindale, as a representative of your Association. If the welfare of the shareholders of these mutual funds was the sole consideration, would you continue, if it was your choice, with this 85 per

cent requirement, or would you change it?

MR. CHIPPINDALE: That is a very deep question. When you say the sole interests of our shareholders, I assume that you are thinking that they are Canadian. Is that right?

MR. STEWART: Well, you tell us that they are predominantly Canadian. Let me make my point quite plain. I think that this is a fundamental question, and I put it to you that the management of these mutual funds, as the management in every company, should be thinking of these things, primarily at any rate from the point of view of the interests of their shareholders.

MR. CHIPPINDALE: Right. And there are a lot of other considerations, not just one.

THE CHAIRMAN: I think you mean, Mr. Stewart, Mr. Chippindale and his associates in discharging their jobs as managers of these funds. You are not giving any wider connotation to it, are you?

MR. STEWART: No.

MR. CHIPPINDALE: But it automatically involves this. If their company is not serviced properly in its fundamental requirements we all suffer, even our shareholders and others. So I do not think you can completely dissociate what are the best interests of Canada from the people of Canada, and so on. If all the people in Canada decided to export their capital, have you any idea what would happen in Canada? I think this is one broad question. I further say ---

MR. STEWART: May I just interrupt you for a

moment and put my question somewhat differently. If you in your capacity as manager of one of these funds were given the right to draw section 69 of this Act, would you put that 85 per cent requirement in there?

MR. CHIPPINDALE: Assuming I were given free option. It is a big thing, but I would not have it in there, of course. I should like complete freedom to do anything I wanted to do at any time.

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But it is not that simple a world, is it? In this brief we say that it is apparently the present policy of the government to have it at 85 per cent. I have raised the question there that maybe it would take a little more than that, so long as Canada remains a capital hungry country. We think the principle is sound, whether it is 15 per cent or 20 per cent. That is open to debate.

If we get what we are asking for here, that will be removed automatically because then every company will be able to consider what it wants to do without reference to that.

MR. PETERSON: I would like to comment, speaking for the investors' group, that there have been times when we would have liked to see a higher rate than 15 per cent, in the interests of what we think are investment considerations.

As you know, diversification is one of the best features of mutual fund investing, and in this country we do not have as wide a diversification as we would like to see it, in certain areas. There is also the matter of liquidity. You have a bigger market in New York, of course, than you have in Canada. Those are two considerations that we think are important. To answer you specifically, speaking for our group we would like to see that increased to, say, 20 per cent or something like that.

MR. STEWART: Would you consider that if it were increased to 20 per cent, that would be adequate?

MR. PETERSON: When you say "adequate", it is

difficult to answer you categorically, but it would be an improvement. It would be, we think, a step in the right direction as far as investment management is concerned.

MR. REID: May I make an observation, Mr. Chairman?

THE CHAIRMAN: Yes.

MR. REID: Again I come back to the conduit of investment trust. We have no problems in any of these areas because our income is transferred directly to our shareholders in the state it is received. So we have, as trusts, no limitations imposed upon corporations.

I think probably what Mr. Chippindale has suggested to the Commission is that if this treatment could be applied to all investment funds, whether incorporated or otherwise, it would be the most desirable, because it would give us the freedom to work in the best interests of our shareholders at all times without forecasting a limitation we might require in 1972 or 1985. We cannot look ahead even six months and say what is the best proportion to have in stocks, bonds, foreign securities, or in cash. So this is a day-to-day consideration.

The most desirable thing is complete flexibility in management, leaving it to the judgment of the investment managers to decide what is the best move to make in the interests of the shareholders. But Mr. Chippindale also pointed out that it seems desirable to encourage the broader ownership of Canadian

equities, and hence in his submission he has gone along with the opinions of our government in wanting to keep as much capital in Canada for investment in Canadian equities and for the repatriation of Canadian equities. Did I say that correctly, Mr. Chippindale?

MR. CHIPPINDALE: Yes.

MR. STEWART: Mr. Reid, I do not want to ask you for information which is not published information with regard to your funds, or which you do not wish to disclose. But so far as your funds are concerned which operate on this trust principle, would you in fact come within this 85 per cent requirement?

MR. REID: At the present time, yes; and I think substantially at all times since we have been operating. We have latitude in investing in the United States, or Europe, or in the Orient. Our considerations are based entirely on what we believe to be in the best interests of our shareholders, without any hindrance at all.

I subscribe to the support of Canadian equities. By investing in the senior securities you release capital to other independent investors to support the secondary industries. Mutual funds by their very nature must have liquidity and we must invest large amounts in individual securities.

Thus we have to stay pretty well in the senior, blue chip type of securities of Canada. This creates somewhat of a scarcity. So we feel that by investing in the senior securities this releases capital for the support of the purchase of secondary

industries, those of a more junior nature, and this contributes to the broader public ownership of Canadian equities.

MR. STEWART: So you consider that in this particular fashion the government is entitled to impose some restriction on the free flow of investment capital?

MR. REID: Of course, Mr. Stewart, the government is entitled to do anything it desires in its judgment.

MR. STEWART: Perhaps I should say that it is desirable that this restriction should be imposed?

MR. REID: I think the prudence of management is in the exercise of a sensible selection. I do not think that the imposition of a limit is generally necessary in our business.

Let us put it this way. If Canada became unattractive as a field of investment, I am sure we would prefer capital performance or capital security ahead of any tax advantage, even if it meant losing a good proportion of the income in the payment of tax.

We would much prefer to secure the capital assets of our shareholders. But it does seem to be unfair to impose something that may work to the disadvantage of shareholders of investment funds when the managers are working in the best interests of the shareholders.

MR. STEWART: This is what I am trying to get at, because in so far as this Commission is concerned,

this 85 per cent limitation is simply a fact. It has been introduced by the government in its wisdom, but that in no sense binds the Commission. If we look at it from the point of view of the long term interests of investors in Canada, the small investors that you people attract, is it a good thing to have?

THE CHAIRMAN: When it suits you, Mr. Stewart, I would like to break, and very soon.

MR. STEWART: Mr. Chairman, this is as good a time as any.

THE CHAIRMAN: We will return at 2:15, if that would be suitable. Would you think that your examination might continue for an hour or so with these gentlemen?

MR. STEWART: I would hope, not more than an hour, Mr. Chairman.

THE CHAIRMAN: The next group would therefore start at about 3:15, and from my review of their submission I would not think that would take much more than three-quarters of an hour.

Mr. Bennett, you might ask them whether that suits them or not. If not, we might make an adjustment.

MR. EMORY: That is quite suitable to us, Mr. Chairman. If we may, we would like to sit in for the remainder of this brief, because it is of considerable concern to us.

THE CHAIRMAN: You do not mind waiting until then?

MR. EMORY: Not in the least, sir.

THE CHAIRMAN: Very well, we will stand over until 2:15.

---On resuming at 2:15 o'clock p.m.

THE CHAIRMAN: Mr. Stewart, where were we at?

MR. STEWART: I was just about to start on a somewhat new tax, Mr. Chairman.

THE CHAIRMAN: Very good.

MR. STEWART: Gentlemen, I would like now to discuss with you the present treatment of companies under Section 69 and then go on to contrast that with the conduit system you propose as an alternative; and I think I would like to ask you to consider this particular situation: Let us suppose that we have a mutual fund and that one particular shareholder's portion of the pre-tax income of that fund is $100.00, and that $80.00 of the $100.00 represents income from the taxable Canadian corporations, and $20.00 of the $100.00 is other types of income.

I would like, in this hypothetical case, to assume, as well, that the effective rate of tax -- personal tax -- payable by this particular shareholder is 25 per cent.

Now, as I understand the present operation of Section 69 the $20.00 is taxable to the corporation at 21 per cent.

MR. CHIPPINDALE: Right.

MR. STEWART: So that the tax on this $20.00 payable by the corporation would be $4.20; is that agreed?

MR. CHIPPINDALE: Yes.

MR. STEWART: And, we will further assume

that this particular mutual fund distributes all it has available for distribution in the way of after tax income, and I think, therefore, that the amount it has available will be $95.80 for this particular shareholder; this being the $100.00 less the $4.20.

Now, we have assumed that his effective tax rate is 25 per cent, but he has 20 per cent dividend tax credits on the whole $95.80; so that the tax he pays on the $95.80 would be 5 per cent of that amount, or $4.79. Can we agree on that figure?

MR. CHIPPINDALE: Yes, I think that follows.

MR. STEWART: So that the total amount of tax paid by the corporation and by the shareholder on this $100.00 is $8.99.

Now, if that is the present position ---

THE CHAIRMAN: I am sorry; the 5 per cent -- you say he had been taxed at the 25 per cent rate?

MR. STEWART: I have assumed that he would have an effective rate of tax of 25 per cent if it were not for the dividend tax credit. This brings it into the upper range of income groups which Mr. Peterson referred to. This is just an example.

Now, I am going to ask you to consider this situation in the first instance from the point of view of the Canadian government. Let us take, first of all, interest income for this mutual fund as from Canadian sources. The Canadian government imposes a 21 per cent tax, and if the fund then distributes the remaining 79 per cent of the interest the shareholder gets a credit of 20 per cent of the 79 per cent, which

represents 15.8 per cent of the original amount.

MR. CHIPPINDALE: I am getting a little bit --- If I understood you correctly -- and I may be wrong -- under your original supposition the company paid a tax of $4.20. This left $95.80; and he would be entitled to 20 per cent credit on the entire $95.80; is that correct?

MR. STEWART: Yes. Let us take the $20.00. I will rephrase my last question so that it relates only to the $20.00; and I am further assuming that the $20.00 is all interest from Canadian sources.

MR. CHIPPINDALE: Well, it wouldn't make any difference whether it was all interest from Canadian sources or from dividends.

MR. STEWART: It is going to make a difference to me. Let us assume that the $20.00 is all interest from Canadian sources.

MR. CHIPPINDALE: Mm-hmm.

MR. STEWART: The government, as we have agreed, will take $4.20 in the way of tax. Now, then, the remaining $15.80 is distributed and the government allows a 20 per cent credit on the $15.80, which is a credit, according to my calculations of $3.16.

MR. CHIPPINDALE: Right.

MR. STEWART: Which is a substantial portion of the $4.20; in fact, it is 75 per cent.

Now, I will assume, if I may, Mr. Chippindale, that this interest income came from foreign sources, or, if you like, that it represents dividends on the foreign shares; so we have $20.00 of that type of

income which, again, the government takes $4.20 in tax. However, if we assume that this is American income, the American government will have deducted 15 per cent --

MR. CHIPPINDALE: Right.

MR. STEWART: -- of the $20.00, which is $3.00?

MR. CHIPPINDALE: Yes.

MR. STEWART: And the Canadian government will have to give a credit for that; so that its $4.20 shrinks to $1.20. It then, as I understand it, proceeds to give dividend tax credit in respect of that income equal to $3.16; so that if my understanding of the operation of this system is correct, the government has netted $1.20 and it has permitted the shareholder a credit of $3.16.

Now, I would now like to come for a moment to your conduit system ---

THE CHAIRMAN: This illustration is in respect of their proposal No. 2?

MR. STEWART: No; I am really back to an earlier stage in this submission where they discuss the present taxation of these incorporated funds and go on to indicate that they think the conduit system is a better system -- a preferable system. This, as I say, is a general principle which they enunciate earlier in the brief before they get on to their specific proposal.

THE CHAIRMAN: This is not the conduit system?

MR. STEWART: What we have been discussing so far is the present system, and now I would like to come to the conduit system for a moment to make sure

that we understand each other on the conduit system.

THE CHAIRMAN: Thank you.

MR. STEWART: We will take our same company with this pre-tax income on $100.00, $80.00 of which is non-taxable and represents dividends from residential Canadian corporations and $20.00 of which represents other income. Under the conduit system the corporate tax, Mr. Chippindale, would be nil.

MR. CHIPPINDALE: Would be what?

MR. STEWART: Would be nothing -- the corporate tax?

MR. CHIPPINDALE: The income is allocated to the shareholders and taxed in their hands as such.

MR. STEWART: In the case of our hypothetical shareholder who has an effective rate of tax of 25 per cent, when we deal with the $80.00, which is the portion which relates to income from taxable Canadian companies, his effective rate of tax on the $80.00 is 5 per cent -- namely, 25 per cent, which is his normal rate, less the 20 per cent dividend tax credit. According to my calculation 5 per cent of $80.00 is $4.00; is that right?

MR. CHIPPINDALE: $4.00 or $40.00 ---?

MR. STEWART: $4.00.

MR. CHIPPINDALE: Yes, $4.00.

MR. STEWART: Now, on the other portion of $20.00 our friend is taxable at 25 per cent, and according to my calculations 25 per cent of $20.00 is $5.00?

MR. CHIPPINDALE: May I just ask you, the

$20.00 we are assuming now to be Canadian funds, not foreign income?

MR. STEWART: We are starting with Canadian interest. We have $5.00 there.

MR. CHIPPINDALE: That is right.

MR. STEWART: The total of the $4.00 and the $5.00 is $9.00.

MR. CHIPPINDALE: Wait a minute. The $5.00 -- I am a little lost here. I have a total of four and one and five.

MR.STEWART: No; I have a total of four and five.

MR. CHIPPINDALE: Under the conduit system the man would receive $100.00. There would be no tax have to be paid; and on this he would be taxable at 25 per cent, which would be -- what -- 25 per cent would be $25.00.

MR. REID: The shareholder receives ninety-one.

MR. CHIPPINDALE: $25.00; and he is entitled to a dividend tax credit of 25 per cent of 80 per cent which is $16.00 (sic); and he would pay a tax of $9.00.

MR. STEWART: So that under the conduit system Her Majesty receives $9.00 in this particular illustration, whereas under the present system she will receive $8.99. These are pretty close ---

MR. CHIPPINDALE: I suggest that what is involved is revenue to the government one way or the other.

MR. STEWART: Now, let me just put it this way, that so far as this particular shareholder is

concerned, it doesn't really make much difference whether he proceeds under Section 69 or proceeds under your conduit system?

MR. CHIPPINDALE: It would appear so.

MR. STEWART: Now, let us take the shareholder who is not taxable at all. Under the present system the tax payable by the corporation is $4.20.

MR. CHIPPINDALE: Right.

MR. STEWART: On an amount of $100.00?

MR. CHIPPINDALE: Right.

MR. STEWART: Now, this $100.00, I would think, might represent the dividend payable on an investment of $3,000.00.

MR. CHIPPINDALE: That would depend; that varies.

MR. STEWART: Let me put it this way, Mr. Chippindale: If you have that investment of $3,000.00 and receive dividends from a mutual fund of $100.00 this is a return of 3-1/3 per cent? Is that fairly close to the mark?

MR. CHIPPINDALE: I would say it is close; it is 3-3/4 per cent -- 3½ to 4 per cent.

MR. STEWART: In other words, it is not far off; and under the present system on this $100.00 there is a tax of $4.20. Under your conduit system there would be no tax at all?

MR. CHIPPINDALE: That is right; thus the shareholder is penalized unnecessarily.

MR. STEWART: And he is penalized to the extent of $4.20 on an investment of $3,000.00, which,

again according to my mathematics, is roughly one-seventh of one per cent of his investment.

MR. CHIPPINDALE: That is correct.

MR. STEWART: And your $3,000.00 man is your average investor?

MR. CHIPPINDALE: He is average; but there are all kinds of variations within an average.

MR. STEWART: But surely you would not suggest that a difference in return of one-seventh of one per cent is a significant return to the small investor?

MR. CHIPPINDALE: If I were a $3,000.00 man I might consider that that was a valuable amount to me. Parliament had already determined that he shouldn't be paying tax; Parliament has said that this particular person was not required to pay tax, and in this way he is required to pay a portion of tax that shouldn't be borne by him.

MR. STEWART: So that for the average shareholder if the return -- the after-tax return -- changes from 3.3 per cent to 3.15 per cent this is very significant?

MR. CHIPPINDALE: Over a period of time it is quite a factor.

MR. STEWART: You think it would appreciably affect the sales of a mutual fund?

MR. CHIPPINDALE: I think it would appreciably affect the income and capital of an investor over a period of time.

I think it has been -- just as an example -- that over the long term, income and compounded income --

there was a very well known life insurance expert who said: "Give me the difference between a 3½ per cent return annually and a 4½ per cent return annually for three years and you can have the principal." It is a very important factor. It may not seem to be so very important, but over a period of time it accumulates.

MR. STEWART: And you maintain the position, then, a one-seventh of one per cent difference in return is a significant difference?

MR. CHIPPINDALE: Well, I am just suggesting that it is not necessary to penalize this person -- this person that Parliament has decreed should not be taxed.

MR. STEWART: When you say that Parliament has decreed already that he should not be taxed, are you referring to the fact that at one point he was not taxed?

MR. CHIPPINDALE: I am referring to the fact that you said that the person was not taxable; and thus Parliament had said he shouldn't be taxed, presumably.

MR. STEWART: He is not taxable on his personal income. I am trying to take the extreme case of an individual whose exemptions exceed his income.

MR. CHIPPINDALE: On the basis of laws passed by Parliament.

MR. STEWART: Yes.

MR. CHIPPINDALE: Right.

MR. REID: May I interject? I think it is rather significant that a retired investor, a man aged 65, can have approximately $12,000.00 of income and attract only the old age security tax of $90.00;

so that the effect on him would be more substantial than in the case of the hypothetical one having $100.00 of income. At $12,000.00 versus $100.00 the percentage would have some significant value to him.

But basically, Mr. Stewart, I think there is a principle here involved rather than a fraction involved; and we maintain that what is available to an invester under one form of investment trust should be available to an investor under another form of investment should be available to an investor under another form of investment, because the principle of service provided is identical.

MR. STEWART: Yes; I appreciate that, Mr. Reid. What I am trying to find out at the moment is how much hardship the present rule imposes on your average investor, and at the moment, if we take an average investor in one of your funds, one who has an income of, perhaps, $100.00, only a small fraction of which will be from interest income, I have not been able to convince myself that there is any great hardship under the present rule.

MR. REID: Don't you think it is a matter of principle? As to the degree of hardship, whether it is significant in one case or not, it is significant in another. I think it is a matter of principle.

THE CHAIRMAN: That is another point, Mr. Reid. Mr. Stewart is trying to get at one point here -- that is, the degree of hardship, and he is pressing on that point. Don't take him away from that. We will come to the principle afterwards.

MR. REID: I am sorry. In the case of the investor with $12,000.00 of income where the attraction of tax is at a minimum,this percentage could be a disadvantage. I don't know whether it would be a matter of a hardship, or whether he would be able to eat less well, but it would be a hardship to a degree -- that this otherwise was not available to him and it could be available to him otherwise. It might just make the difference of his selecting another mutual fund than the one he was considering.

MR. STEWART: But so far as investment funds, or mutual funds, generally are concerned, this case is not the typical case?

MR. REID: No; we don't represent the bulk of the industry.

MR. STEWART: I beg your pardon; I mean that the open-end mutual fund doesn't have this type of person as a typical investor?

MR. REID: Not as an average investor.

MR. CHIPPINDALE: Mr. Chairman and Mr. Stewart, if I may simply interject at this point, we have carried through one hypothetical case, and there can be probably a thousand factual variations within companies, and of the 300,000 shareholders we can't possibly prove this that and the other on looking at them; but in the two cases we have taken, the revenue to the government in the first instance was one cent different from $9.00; the second example resulted in a situation that the shareholder paid tax when Parliament had decreed that he should not be paying income tax.

If I may, I would like to read this. I don't want to encroach on your time ---

MR. STEWART: It is not necessary to read it, if you would just direct us to the section you have in mind.

MR. CHIPPINDALE: Well, I would like to direct your attention to Section 53 on page 39.

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MR. STEWART: This is a section where you suggest that there is discrimination as between different types of investments?

MR. CHIPPINDALE: Yes. We say that it may be relatively small but nevertheless it is very unfair and irritating.

MR. STEWART: All right.

MR. CHIPPINDALE: If I may just make this statement, in section 69 it appears to have been the intent of the government to collect at the corporate level of taxation non-Canadian dividends. Originally the tax was 20 per cent, the same rate as the combined income tax and old age pension tax. But when the old age pension tax was raised from two to three it made the effective rate 21 per cent. The basic intention was to collect from the corporations at the corporate level the tax which the shareholders were gaining on investments. But the trouble is that that was applied to all the different kinds of shareholders, particularly the smaller and the older people who would not be paying tax otherwise. They are being unnecessarily penalized to somebody else's advantage who probably is not entitled to it.

THE CHAIRMAN: It seems to me that Parliament has decreed that under the circumstances it be a tax which should be imposed. You say that because it is a conduit Parliament did not intend that they should pay that tax. Parliament simply said that if these people have a small income below the exemption level and did not have anything to do with an investment

company, that they would not pay tax. Parliament also said that when they do have something to do with an investment company they should pay tax. I do not know why Parliament changed its mind, but I do not think that you can put the first decision against the second decision, or the second decision against the first decision. I think they are two separate decisions by Parliament.

MR. CHIPPINDALE: Well, we have the unincorporated companies. That is an example of where these credits flow through. In 1946 the tax laws of Canada were such that incorporated companies who complied with the provisions of the Act were completely exempt from the Income Tax Act. When the question of the dividend tax credit arose a lot of thought was put into this over a period of time to try and find some equitable and simple way for the incorporated company shareholders, on the average, to be in about the same position as the unincorporated shareholders.

THE CHAIRMAN: Yes, we understand all that. That is in your brief.

MR. STEWART: I should like to come to your proposal No. 1, which begins on page 40. I do not think I need deal further with paragraph 1, in which you suggest that the conduit principle should be applied, or with paragraph 2 which deals with the flow through of tax credits, because we have discussed that.

In paragraph 3 you make the further suggestion, which is that dividends which represent a distribution of capital gains or return of capital should be non-

taxable to Canadian residents who are shareholders. Would you suggest that the rule which applies to mutual funds in this connection should be any different from the rule which applies to other corporations?

MR. CHIPPINDALE: Yes. These are capital gains, and this suggestion is based on the fact that the unincorporated funds today can always do just that. It is just to make them uniform when they are operating the same business.

MR. STEWART: But the other type of organization, if I may say so, does not do just that, because the capital gain in the case of the unincorporated fund is not the gain of the corporation. Nor is the capital the capital of the corporation.

I am putting this to you, that if any ordinary corporation cannot distribute capital gains free of tax or cannot return its capital to its shareholders without complying with the reduction of capital provisions and the consequent tax provision, there would have to be a very compelling case indeed for distinguishing between one of the mutual funds and these other types of corporation, if we were going to give your type of corporation benefits which other corporations do not have.

MR. CHIPPINDALE: They already have substantial benefits compared with other corporations. That was determined years ago under Section 59, is it? They already had been considered to be under present tax legislation as conduits of this nature, and their tax position is vastly different from an ordinary

business corporation.

MR. STEWART: But under the present legislation they certainly have a favoured position, primarily because they pay tax at 21 per cent rather than 52 per cent or whatever it may be. But your funds over a period of years presumably may realize very substantial capital gains. If an ordinary corporation distributes a capital gain by way of ordinary dividend, its shareholders are taxable on that dividend. If an ordinary corporation makes a return of capital to its shareholders -- I am talking now about common share capital -- it must reduce its capital, and if at the time it does this it has undistributed income, its shareholders are taxable on their portion of the undistributed income.

MR. CHIPPINDALE: But not on the capital in those circumstances. Is that correct?

MR. STEWART: No, I am afraid that is not correct. If an ordinary corporation at the present time chooses to reduce its common shares at a time when it has undistributed income on hand, then its shareholders are subject to tax on their portion of the undistributed income.

MR. CHIPPINDALE: But not the capital that might be involved in the reduction of capital.

MR. STEWART: But they are all the same dollars. All they get are dollars.

MR. CHIPPINDALE: If I may suggest, mutual funds distribute this income every year in full. Or most of them do.

MR. STEWART: Is there anything to prevent a mutual fund, if it has no undistributed income, from declaring a dividend in the amount of its realized capital gains, and paying a stock dividend in preferred shares, which it then proceeds to redeem free of tax in the hands of its shareholders?

MR. REID: If I may say so, Mr. Chairman, I set up a company to do just that several years ago, and each year it pays out 100 per cent of its earnings, and then has its special preferred shares that are distributed and redeemed almost simultaneously. It achieves the distribution of capital without attracting the tax in the hands of the shareholders. But this is complex. In a sense it is like sawing sawdust. In the case of an investment trust we have no problem in achieving this. It is done so simply that certain provisions have been made under the Income Tax Act to make the function of an investment fund as close to a conduit as possible, and it would seem practical and desirable to find some measure to provide the same for an incorporated fund.

MR. STEWART: Well, I am trying to emphasize that this would be a radical departure from the principles which are applicable to other types of corporation.

MR. CHIPPINDALE: May I suggest that that is already inherent in this type of company, and already recognized in the tax law as a principle. All we are asking is that people in the same business, one acting as an unincorporated trust and one acting in

incorporated form doing the same business, should be treated in the same way for tax purposes.

THE CHAIRMAN: It is not right to say, is it, that the main difficulty with regard to a corporation in permitting such a tax free distribution is that before you could get capital gains out of it you would have to take out all the undistributed income?

MR. STEWART: In a case of an ordinary corporation that is true, Mr. Chairman.

THE CHAIRMAN: In this case they do not pay any because it has gone.

MR. STEWART: It may vary to some extent from company to company, but I do not think they distribute all of it.

THE CHAIRMAN: I made a careful note at the beginning as to what the distribution is and as to how they get it. The unincorporated ones assume it like a partnership would.

MR. STEWART: Can you expand on that, Mr. Chippindale, and say whether your members do in fact distribute all their earnings after tax?

MR. CHIPPINDALE: I can say that the law requires the distribution of 85 per cent, and as a matter of practice I do not know of any company -- this is an open end mutual fund we are talking of now -- that does not distribute all its income every year within a minute fraction. It is the intention to pay it all. In actual operation perhaps you pay out a little more than that, but as a general principle the open end mutual fund pays out all its income each

year.

THE CHAIRMAN: Do you intend that the shareholders shall be taxed on all the income that has been received, whether or not you have precisely distributed it during the year, just in the same way as an incorporated fund?

MR. CHIPPINDALE: That would require a full distribution of earnings.

THE CHAIRMAN: The tax department would not even be concerned with regard to how much you had paid out because they would be taxed as though they had been.

MR. CHIPPINDALE: Yes, but it is the practice of a mutual fund to pay out all its income.

THE CHAIRMAN: That is what is intended by this, is it?

MR. CHIPPINDALE: Yes. It was my understanding when the law was passed that the reason it was not put at 100 per cent but at 85 per cent was in order to allow for unforeseeable contingencies in the area of the manner in which portfolio companies might declare a dividend. For instance, many years ago International Harvester Company, being a United States corporation where the tax laws are different, sent a report to shareholders in about the fourth month before the close of the fiscal year which simply said that they capitalized some surplus last year. Under our tax laws at that time that was deemed to be income and no one knew anything about it. That margin was put in there to allow for such unforseeable contingencies, with the expectation that a full distribution would be

made.

THE CHAIRMAN: I am saying that there would be no such provision in the law. There would be no 85 per cent, no 95 per cent and no 100 per cent. There would be a provisions similar to that covering personal corporattions, that the income is deemed to be distributed.

MR. CHIPPINDALE: Right.

THE CHAIRMAN: And your information on returns would be deemed as though it had been distributed, whether or not you paid it out.

MR. CHIPPINDALE: Yes, that is so. That would put the onus on the corporation, of course, to distribute it.

MR. STEWART: As I understand proposal No. 2, the essential difference between it and proposal No. 1 is that the recipient of the dividend from the mutual fund would be entitled to the 20 per cent dividend tax credit, not just on the portion of his dividend which can be regarded as a flow through of dividends from taxable Canadian corporations, but on the whole of the dividend, no matter what the nature of the underlying income was.

MR. CHIPPINDALE: That is correct.

MR. STEWART: So that if I put this case to you as a possible case, if we assume that a particular mutual fund in 1954 has non-Canadian equity income, or non-Canadian income --- I am sorry, I will rephrase that question. Let us assume that we have a mutual fund which has income from taxable Canadian corporations

amounting to 60 per cent. This is assuming that these are common stock dividends.

MR. CHIPPINDALE: From Canadian companies.

MR. STEWART: Yes.

MR. CHIPPINDALE: That is $60.00 out of $100.00.

MR. STEWART: Yes, $60.00 out of $100.00. It has 25 per cent of this income in the form of interest from Canadian corporations, and it has 15 per cent of its income in the form of dividends on preferred shares ---

MR. CHIPPINDALE: May I suggest that in that case you could not qualify as a conduit under the proposal if you have only 60 per cent of your income from Canadian stocks.

MR. STEWART: Excuse me, I am afraid I have not made myself clear. The 60 per cent is from Canadian common stocks. The 15 per cent is from Canadian preferred stocks, and 25 per cent from Canadian interest. So that 100 per cent of your income is from Canadian sources.

Now, let me give you an extreme case. Supposing the 15 per cent which I said was Canadian preferred stocks is actually foreign source income, so that you have 85 per cent Canadian, 15 per cent foreign source. Now, 40 per cent of that income would, under Section 69 as it is now, be taxable in the hands of the corporation; 40 per cent of it, under your proposal No. 1, would be taxable in the hands of the individual shareholders.

MR. CHIPPINDALE: I am sorry. The entire amount would be taxable in the hands of the individual shareholders, and they get certain credits.

MR. STEWART: Yes, I beg your pardon. However, under your proposal No. 1 40 per cent would be taxable in the hands of the shareholder without any dividend tax credit.

MR. CHIPPINDALE: Under proposal No. 1?

THE CHAIRMAN: He said 40 per cent without tax credit.

MR. CHIPPINDALE: That is right. Sixty per cent would carry tax credit and 40 per cent would not.

MR. STEWART: Under proposal No. 2 ---

MR. CHIPPINDALE: I am sorry. Under proposal No. 1 15 per cent was derived from foreign sources. He would be entitled to a foreign tax credit on that portion under a conduit principle.

MR. STEWART: That is right, but not to the Canadian dividend tax credit.

MR. CHIPPINDALE: No. He gets 15 per cent on that amount and 20 per cent on the other $60.00. In addition to that he would be entitled to take whatever depletion allowances there are in respect of that 60 per cent, and there are some. To a large extent we are a financial resources economy, and I think every mutual fund portfolio in the country owns stocks in companies who are allowed to take depletion allowance ranging from anything between 10 to 20 per cent, and they would also flow through.

I am suggesting that perhaps the easiest

thing to do would be to allow a man a 20 per cent dividend tax credit on the whole amount in lieu of what he would otherwise get, first of all from his 20 per cent on his Canadian dividends, secondly his 15 per cent on the foreign tax credit, and thirdly whatever depletion allowances would be involved in what he would otherwise get through a straight conduit. I say that it would amount to about the same thing, but it would be much simpler.

MR. STEWART: You are not suggesting, are you, that what he gets by way of dividend tax credit more than makes up for the foreign tax he has paid?

MR. CHIPPINDALE: I am sorry, I am not sure I understand that.

MR. STEWART: Let me just deal with this $15.00 that we ---

MR. CHIPPINDALE: That is interest. That is the maximum. It is the extreme case.

MR. STEWART: Let us take the $15.00 which is income from foreign sources. Let us suppose he has paid $3.75 to the United States through a deduction at the source.

MR. CHIPPINDALE: Yes.

MR. STEWART: The only purpose of the Canadian foreign tax credit, surely, is to permit him to bring that $3.75 into account?

MR. CHIPPINDALE: Well, to get that relief to the extent that he is taxable himself on the $15.00; to be able to offset that tax ---

MR. STEWART: But he has still paid the foreign tax of $3.75. You cannot help that.

MR. CHIPPINDALE: That is right; and he turns around and takes it off here, which he is not allowed to do now, incidentally, but which he would under proposal 1.

MR. STEWART: In any event, I put it to you that under proposal No. 2 as much as 40 per cent of his dividend might relate to matters or items which would be taxable to the shareholder under proposal No. 1. Under proposal No. 2 you say the government should forego any claim for tax on that 40 per cent?

MR. REID: May I observe on this, Mr. Stewart, that the theory here would be that the main income of the fund is from dividends of Canadian taxable corporations and that interest income and dividends from foreign corporations is only incidental. So 40 per cent would not be incidental.

MR. STEWART: But I am putting to you --

and this is the very matter I am concerned with -- that as the law now stands, it could be as much as 40 per cent?

MR. CHIPPINDALE: What we have not determined yet, of course, is what proportion would be entitled to depletion allowances, and they are very tangible credits. It is just my suggestion that it would certainly be a lot more simple for the government, for the shareholder, and for everybody else, to allow 20 per cent of the total in lieu of what otherwise would be represented by the 20 per cent dividend tax credit on Canadian dividends, along with tax credit on foreign income and depletion allowances on a proportion, and that proportion can be fairly substantial. I think it would come pretty close to washing out, if everything were taken on an extreme example. But I do not think they run to extreme limits in these things as a matter of actual practice. I know that in my own company for the year just ended the proportions went 14½ per cent foreign income. That was primarily because Du Pont paid a dividend in the form of General Motors' stock. Normally our proportion would have been closer to 11 per cent. Our interest income amounted to 18 per cent. Those are actual figures operating well within those limits. We had the choice of going further than that. So I am trying to take on an average what I think happens in practice. Sometimes we would not have as much as 18 per cent from interest in these types of funds. You are feeling pretty carefully. They are relatively high market levels when

you get as much as 18 per cent income from interest in this type of company. That happens part of the time; at other times it would be materially lower than that.

This is the request made. I think it would certainly facilitate things for everybody concerned if it were done that way. I think it would encourage, if you will, the use by investors in Canada of this type of vehicle, which I think is performing a tremendous function to the good of the Canadian economy. I think it should be encouraged to the maximum degree, if it does not result in any serious disabilities to the federal Department of Revenue.

Mind you, these are free enterprise institutions in which the government is not assuming any risks, any costs, and without any trouble to the government and they are being utilized by more and more people, who must be convinced that they are a good vehicle for them.

What we are trying to do is just ask that this taxation be imposed in its simplest form without any material change in the tax revenues of the government, to the convenience of both the government and the shareholders.

THE CHAIRMAN: The advantage that you have cited of proposal No. 2 over proposal No. 1 is an administrative advantage; I think that is the only thing you hold for it, is it not?

MR. CHIPPINDALE: It is a matter of convenience.

THE CHAIRMAN: It would seem to me that

providing you do what we spoke about with regard to proposal No. 1, it does not represent any real administrative difficulty. You make out your information returns, and I would think you are responsible enough people that they do not have to be checked very carefully.

MR. CHIPPINDALE: Thank you.

THE CHAIRMAN: You would turn those in, and there would be the duplicate of the shareholder's account. I think it would work just like ordinary dividends and I cannot see very much difficulty there.

But when shareholders move in and out of your funds, as they do very properly, that means, I presume, that the least assured dividends would represent a very long list, would they not, although I suppose that is the case right now?

MR. CHIPPINDALE: When a person comes into one of these funds, he pays an amount which represents the capital value of the accrued income.

COMMISSIONER GRANT: Plus his cost of getting in?

MR. CHIPPINDALE: I am talking about the fund itself now. The acquisition cost is added by the distributor. The company does not enter into that at all. But the company gets an amount that represents the capital and income value of the equity at that date.

If one goes out, the same thing happens in reverse. He gets the liquidated value, which is a composite of the capital value and the accrued income,

all figured out to seven decimal points on that day, so we know exactly where everybody stands at that time.

THE CHAIRMAN: You know exactly how many days it has been in the fund and the amount of money he received?

MR. CHIPPINDALE: Yes, and the amount of money he received. I argued alongthose lines, Mr. Chairman, myself years ago, but it was thought by others that it would present administrative difficulties. That is not my contention; but that was the feeling at that time. It was certainly a valid feeling -- I am not criticizing this -- so I came up with this as a solution to any problem which anybody might have in mind along those lines.

THE CHAIRMAN: But you prefer proposal No. 1?

MR. CHIPPINDALE: It is not too material. I think I would prefer No. 2 if the Department were agreeable to it. It does make it simpler. No. 1 is certainly an improvement over the present situation.

THE CHAIRMAN: As an accountant, I would have thought if you went to proposal No. 2, you would just have your accountants working out the optimum position at every level of income, and your investment decisions might be to some extent influenced by taxation. Taxation would not be wholly neutral. Under No. 1 I would think it would be wholly neutral.

MR. CHIPPINDALE: I am not sure that I get your point, Mr. Chairman.

THE CHAIRMAN: It is simply that your fund would pay more or less tax under proposal No. 2,

depending upon your choice as to investments, whereas under No. 1 it would make no difference.

MR. CHIPPINDALE: It would make a difference.

THE CHAIRMAN: It would make a difference to the individual.

MR. CHIPPINDALE: Because the more foreign influence we have, the less favourable the position of our shareholders as individuals.

MR. STEWART: Under proposal No. 3, which you put forward somewhat less forcefully, because you simply say that this is a meritorious idea, you suggest that dividends from mutual funds should be excluded from income either altogether or up to $100.00 per shareholder.

There again, I take it, if dividends were excluded to up to $100.00, the vast majority of your shareholders would not be taxable on dividends at all?

MR. CHIPPINDALE: Well, certainly some of them would not, depending on their other income, of course.

MR. STEWART: We have already agreed that your average shareholder has an investment of $3,000.00.

MR. CHIPPINDALE: In this alone. But he may have others.

MR. STEWART: He may. But if we assume this is his only equity investment in shares and if we assume the 3-1/3 return on $3,000.00, we get $100.00?

MR. CHIPPINDALE: Yes.

MR. STEWART: So that particular person would be paying no tax at all on his dividend income?

MR. CHIPPINDALE: Some will not. The only thing I could not concur in, because I just cannot figure it out, is whether it is the great majority, that is all, because there are other, different kinds of income. I would hate to think that a person had all his savings in one mutual fund.

THE CHAIRMAN: And had no other income?

MR. CHIPPINDALE: And had no other income. I would not think that would be a proper position.

THE CHAIRMAN: That might be so in the case of a widow, I suppose.

MR. CHIPPINDALE: I would never recommend it, and I never will. It is only suitable for a portion of one's investment capital.

MR. STEWART: But we are now talking about dividend income, are we not?

MR. CHIPPINDALE: That is right; but they can have other securities, and usually do.

MR. STEWART: In other words, your average member holds shares other than his mutual fund shares?

MR. CHIPPINDALE: I cannot say that. All I can say is that over the 31 years our recommendation has been that it is suitable for a portion of the investment savings of practically any investor. I have never suggested that it was suitable for a person's entire savings. He should have a bank account for emergency cash purposes; he should have suitable life insurance; I would think he should have a suitable amount of government bonds in the form of Canada Savings bonds or other liquid savings, and then,

depending on what their position was, how old or how young, how little or how much, all kinds of things, some portion of the total savings could be put very well into one of these vehicles, and they might have one or two individual stocks as well.

I think a great number do this. I cannot make a statement as to what proportion, but certainly that is what we have recommended. I can send you printed material to that effect. That is all I can say.

MR. STEWART: You have saved yourself by the bell there, Mr. Chippindale, because the person who has the bank account, and the person who has some life insurance, and the person who has some government bonds is not getting dividend income from those sources.

MR. CHIPPINDALE: No, but in addition to that he can have -- and a great many do have -- other things. Practically everybody has a pet stock. Practically everybody owns some Bell Telephone.

MR. STEWART: Including most of your 300,000 members?

MR. CHIPPINDALE: Certainly a lot of them. I cannot say most, but I will say that a great number of the people that own shares in an ordinary mutual fund are the type of people who would probably also own some Bell Telephone stock. That is my judgment.

MR. STEWART: I should have thought that your salesmen would be going around convincing people

that the advantages of mutual fund shares are their great diversification, the excellent management behind the fund, and so on, and the average person should put everything he has available for investment in the stock market in mutual fund shares.

MR. CHIPPINDALE: No.

MR. STEWART: He does not?

MR. REID: There might be a difference of opinion here.

MR. PETERSON: I am afraid I could not subscribe to that either. I think a great many of our clients have no other equities, investments, and I think this is one of the virtues of this type of investment. Some people -- not sophisticated investors -- do not have the means today, and some do not have the knowledge and are paying for professional management; but they are the exception rather than the rule.

MR. REID: In our case we provide a bond investment along with equity investment to provide an opportunity for balancing, to meet individual requirements. Again, different companies have different policies.

MR. STEWART: Quite so.

MR. CHIPPINDALE: Proposal No. 3, as it says, is not a request, but we do think it is a meritorious idea. It is only meritorious if the government feels that we are serving the national interest in a fashion that makes it worth considering that. That is only in the nature of partial relief,

really, from double taxation. I have read a number of briefs where they have requested that this be applied 100 per cent to all stocks. We are very modest in this suggestion.

MR. STEWART: Now, Mr. Chippindale, I would like to look at paragraph 49 of your brief, which is on page 36, and ask you a question about it. There you are dealing with the question of investment on the one hand and trading on the other.

As I understand the effect of paragraph 49, it is this: First of all, if an investment or a security is held for 90 days ---

MR. PETERSON: Or more.

MR. STEWART: If it is held at least 90 days, then the trading character is eliminated?

MR. CHIPPINDALE: I should think it is almost eliminated, if not completely so. The trader does not aim to hold stocks 90 days.

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MR. STEWART: You are suggesting it should be eliminated at 90 days.

I also understand, from paragraph 49, that you suggest that as long as the realized losses on trades of securities held by less than 90 days exceed the profits on securities held for less than 90 days, the corporation should not be classed as a trader.

MR. CHIPPENDALE: If the corporation has no profit -- if it does not have a profit there is no tax on no profit; but if it has a profit on the sale of securities, then, if more than one-third of that net profit arose from securities proportionately held less than 90 days, I should think it would be verging on a trading company.

This is not original with me. I think this is substantially the method used in the United States for the same purpose.

MR. STEWART: I am putting it to you in this way, that if your paragraph 49 means what it appears to mean, then a corporation can make 10,000 trades in the course of a year, it could hold nothing for more than 90 days, and as long as it made no net profit, it should not be regarded as a trader?

THE CHAIRMAN: Not as a successful trader.

MR. CHIPPENDALE: What is the difference whether it is or not? If there is no profit what is the difference whether it is or not? Under those

circumstances there is no profit to tax.

MR. STEWART: But, Mr. Chippendale, it is said that the record can't change its spots, and supposing a company was an unprofitable trader one year but next year it began to be more successful, are you suggesting that its trading record in the previous year should not be taken into account in determining whether or not it is ---

MR. CHIPPENDALE: No; I am suggesting that each year be considered on its own merit.

THE CHAIRMAN: I think we will have to explore this a little further.

MR. STEWART: But not now.

MR. CHIPPENDALE: It would be much better, obviously, if you carried your losses forward, but I am suggesting that each year be considered on its merit.

MR. STEWART: I think this is about as far as I can go on this.

THE CHAIRMAN: I think you have covered it pretty fully. I have been making notes of my questions and I have crossed practically all of them off this list.

COMMISSIONER PERRY: I have one question. I am just taking it for granted that you are assuming, in your second proposal, that the whole income would be distributed each year?

MR. CHIPPENDALE: That is right.

COMMISSIONER PERRY: I don't think that the proposal, as it is drawn up, is put in

such a way ---

MR. CHIPPENDALE: That is the way in which it was intended to be suggested. That was the intent.

THE CHAIRMAN: You give us careful assurance that that was the intent on that point?

MR. CHIPPENDALE: Yes.

COMMISSIONER GRANT: I have one question which I would like to ask. I would like to get your reaction to this, that the law, as we now have it, says that if you want to go into the investment trust type of business you can go into it in three ways. One is that you can go into it as an unincorporated organization.

MR. CHIPPENDALE: Right.

COMMISSIONER GRANT: In that case you don't rid yourself of personal liability, because the shareholders in this sense are liable for their losses as individuals.

MR. CHIPPENDALE: They are. In this case the onus is on the shareholders themselves. No business manager is involved in this type of trust. It is just the shareholders.

THE CHAIRMAN: You explained before that the term "shareholder" was very loosely used and that you meant the participant rather than the shareholder because it was unincorporated.

MR. CHIPPENDALE: Yes.

THE CHAIRMAN: So that I am assuming that the organizers of this unincorporated investment trust would be licensed as a partnership of the

province in which they were doing business to carry on under a certain name.

MR. REID: An investment trust set up under a trust indenture involves a contract between the trustee, being a chap of Canadian trust company and, secondly, the investment manager and, thirdly, the shareholder, or beneficial certificate holder. The assets are owned 100 per cent by the beneficial certificate holder. The trustee and the manager are simply employed by them in their capacities. They have no equity in the trust themselves other than the investment contract or trustee contract. They may be disposed of by these certificate holders. They have no equity other than their managerial-trustee contracts. The assets are owned 100 per cent by the certificate holders in the trust, and consequently all income is owned pari passu by the certificate holders. It is passed to them in each taxation year to 100 per cent.

COMMISSIONER GRANT: Then, there is no personal liability on the part of the organization?

MR. REID: None.

THE CHAIRMAN: Thank you very much, gentlemen. I found your Table 1 most encouraging, if I read it correctly -- and I think I did -- in that Canada in a year and a half has repatriated some $218,000,000 worth of stocks; and I know that that has been done to the extent of $120,000 by your organization. That is most highly commendable, and I hope it continues.

We have no further questions. I think we understand what you have put before us so very clearly. If there is anything further, before we come to the close our staff might get in touch with your organization through Mr. Whitehead, I would assume.

MR. CHIPPENDALE: Thank you, Mr. Chairman. As I mentioned earlier, we do appreciate this opportunity to be here and discuss the situation with you, and certainly if there is anything else we can do to be of assistance in furnishing information we will be delighted to do it.

Thank you very much.

THE CHAIRMAN: Yes, Mr. Secretary?

SUBMISSION OF

THE ASSOCIATION OF CANADIAN INVESTMENT COMPANIES

APPEARANCES:

Mr. J. B. Emory
Mr. T. A. Relyea

THE SECRETARY: Mr. Chairman and Commissioners, the next brief this afternoon is to be presented by the Association of Canadian Investment Companies.

Mr. J. B. Emory, the Director of the Association, is here to speak to the brief. Mr. Emory is President of United Corporation Limited, Montreal.

Associated with him this afternoon is Mr. T. A. Relyee, a member of the Association. Mr. Relyea is President of Canadian Financial and Foreign Securities Company Limited of Toronto.

Mr. Chairman, I would like to enter this brief in the record as Exhibit 321.

--- EXHIBIT 321: Brief of The Association of Canadian Investment Companies

THE CHAIRMAN: Mr. Relyea, we are very glad to see you. We read your submission with much interest. It raises a few questions which we would like to explore; but before we do have you got any preliminary statement?

MR. EMORY: I would like to make one, yes.

THE CHAIRMAN: Yes.

MR. EMORY: It certainly is not my intention to make any extensive remarks this afternoon since we have filed our brief with you and it contains, in as concise a form as possible, the reasons for our presence here.

I would, however, like to tell you that this is the first official act of our Association.

It is an Association of closed-end investment companies known as the Association of Canadian Investment Companies. The Association is modelled after the British Association of Investment Dealers and in our present rather embryonic form we represent eleven companies without it, at December 31, 1962, of about $240,000,000. It might, in passing, be of interest to note that the British Association has 258 members whose assets exceed two thousand million pounds so that we have a lot of scope for growth, and we feel that the potential for growth does exist in this country provided we are given reasonable freedom of action under our tax and other laws. It is, of course, primarily to factor this growth that our Association has been formed.

It was because of our common belief that the restrictions imposed by the present tax laws on our type of company unduly inhibit our freedom of action and, hence, our potential for growth, that we have asked to be heard this afternoon,

for it must be remembered in our case that growth does not primarily come from the sale of new shares but from the return received on a relatively fixed amount of money.

You will have noted from our brief that we are asking that consideration be given to some relaxation of the restrictions placed on our foreign investments by the present tax law.

With your indulgence I would like to make a few further brief comments on this subject. However, I am sure you will understand that it is impossible to cover such a broad field adequately in the time available, and my remarks will, therefore, only briefly touch on a few high spots.

I think that everyone in this room will agree that pools of capital available for investment purposes, whether they take the form of open-end investment companies, closed-end investment companies, pension funds, or what have you, perform a very real and important economic function in our present society. If this initial premise is granted, it seems to follow naturally that such pools of capital should be as free as possible to seek for the greatest return on investment consistent with reasonable prudence, for it is only by achieving this return on investment that these pools of wealth can grow and pass the benefits of such growth on to the economy as a whole.

We recognize that, at the present stage of Canada's development, a case can be made of the

desirability, from the national point of view, of employing a major proportion of our investment capital domestically. This we are quite happy to do, and, indeed, I think that it would be found that even in the years prior to 1955, when investment companies had almost complete freedom of investment choice, the major proportion of their assets were, in fact, invested in Canada. Even were this not so, however, we submit that the best method of encouraging Canadian capital to stay at home lies in so managing our national affairs that this country provides the most attractive area for investment rather than in restricting capital movements by law. The carrot, in our view, is always better than the stick, and, at any rate, it certainly makes for a happier horse!

Finally, gentlemen, the members of our Association are not convinced that foreign investment by Canadians is necessarily, per se, a bad thing for this country from the balance of payments point of view. It is to be hoped that such an investment would be intelligently handled and would grow as a result, so that an initial commitment of, say, $1,000,000 would be worth considerably more than that in a few years' time. This is the same thing as saying that an initial requirement for $1,000,000 in a foreign currency would, in a few years' time, give this country a considerably larger claim on their currency. In addition, of course, the remission of income to

the Canadian investor would provide a continuous inflow of that currency during the intervening years. The net effect, then, is beneficial to the Canadian balance of payments over the long run and, in fact, during the period that the investment is in being, Canada actually has a very real, though intangible claim on foreign assets that, particularly in the case of investments of the portfolio type, could be realized in the event of a real emergency. It is only necessary to look at the experience of the British during the last war to see a practical demonstration of the validity of this argument.

With your permission, I would like to ask Mr. Relyee to read into the record the names of the closed-end investment companies which this Association represents, and to make a few further brief comments.

THE CHAIRMAN: Thank you, Mr. Emory.

MR. RELYEA: Mr. Chairman and Commissioners, the Association of Canadian Investment Companies represents the following closed-end investment companies -- and I will also give their net assets as at December 31, 1962:

Canadian Foreign Securities Company Limited ($7,838,000)

Canadian International Investment Trust Limited ($5,919,000)

Canadian Power and Paper Securities Limited ($11,338,000)

Dominion and Anglo Investment Corporation Limited ($15,162,000)

Dominion-Scottish Investment Limited ($10,459,000)
Economic Investment Trust Limited ($15,960,000)
Electra Investments(Canada) Limited ($1,455,000)
Great Britain and Canada Investment Corporation ($15,531,000)
Pacific Atlantic Canadian Investment Company Limited ($2,978,000)
Power Corporation of Canada Limited ($113,416,000)
United Corporation Limited ($41,868,000)

That makes a total of $241,924,000 as of December 31, 1962. This would be considerably higher today due to higher stock prices.

Until 1955 Canadian Investment Companies were exempt from income tax provided at least 85 per cent of income was distributed to shareholders.

In 1955 an income tax of 20 per cent was imposed to make it possible for investment company shareholders to qualify for the 20 per cent tax credit.

This equalization tax has worked well. Its net effect has been to permit our common shareholders to receive the 20 per cent tax credit on the portion of income from Canadian dividends and not on the portion of income from bond interest and foreign dividends.

The tax is simple to calculate for the investment company and inexpensive to administer for the Tax Department. Furthermore, the shareholder knows exactly where he stands taxwise in respect of his dividends.

This is in marked contrast to a flow through of conduit form of tax which would be complicated and cumbersome to calculate and expensive to administer. With conduit tax you would also create unnecessary difficulty for investment companies who have preferred shares outstanding.

We are here today to appeal for a modest relaxation in the 1961 legislation which has progressively tightened the restrictions on the foreign income of investment companies until we no longer retain the minimum of flexibility in investment policy required to protect the interest of our shareholders.

Our basic function is to provide for our shareholders the investment management which the trust companies provide for their large investor clientele who have no restrictions on their investments.

We submit that reasonable flexibility in management can be restored to investment companies by simply raising the limit on foreign income from the present 15 per cent to 30 per cent.

We appreciate that the present emphasis in government policy is to encourage investment in Canada, and with this we wholeheartedly concur. Our recommendation would not only make possible the necessary diversification and participation in representative industries not present in Canada, but would also ensure that the major portion of our investments remain in Canada.

We will be happy to answer any questions that you may have, to the best of our ability.

THE CHAIRMAN: Thank you, Mr. Relyea.

Speaking about the companies and your organization, I would be interested in knowing to what extent they are Caanadian-owned. Some of those names that you read off to me sound as though the origin of the company was not Canadian.

MR. EMORY: I think that would be a fair statement. The closed-end companies in this country go back a considerable period of time -- in a great many cases, back to the 1920's -- and at that time it was the policy of Canada to encourage foreign investment. These companies in many cases were actually formed to encourage larger United Kingdom investment in Canada.

Speaking for my own company, we are approximately 30 per cent owned in England, and that has been the case for years.

THE CHAIRMAN: Some of those companies would be owned more by non-residents and some less.

MR. EMORY: I would guess so.

THE CHAIRMAN: You would not have any idea of what the total compensation of sales of all the companies would be?

MR. EMORY: I am afraid I have not. There is one difficulty in this business, in trying to sort your shareholders out, and that is that even if you look at the shareholders list you do not always know who the shareholder is. A great

many of these shares are held in marking names. By that I mean in the name of bank nominees, or trust companies; so that you do not know who the individual shareholder is, or if he is Canadian or foreign.

THE CHAIRMAN: Mr. Emory, the company's shares that you have referred to are traded regularly, are they not?

MR. EMORY: Some of them are traded more frequently than others.

I would guess that 50 per cent would be listed on the Stock Exchange; possibly more.

MR. RELYEA: That is the distinction. The listed shares trade more frequently than the unlisted shares.

THE CHAIRMAN: The unlisted shares would trade over the counter market, that is all.

MR. RELYEA: Yes. I think it is true of all these companies that the maturity and the shareholders are long term, so that probably there is less trading in these shares than in the normal shares of companies.

COMMISSIONER PERRY: I was wondering whether your members are members of the Mutual Funds Association. I gather that they are not.

MR. EMORY: No. We are in the same business, but for a slightly different end.

COMMISSIONER PERRY: You have a slightly different brief too!

COMMISSIONER GRANT: I should just like to make one comment, and that is this. When you mention trust companies are under no restrictions, I am sure a great many of these companies are under accepted restrictions as contained in the instrument creating the trust under which they are operated.

MR. RELYEA: Yes, I appreciate that. I meant that they are under no government restrictions as to the distribution of their investments.

COMMISSIONER GRANT: I think it is fair to say that they are definitely under government restrictions.

MR. EMORY: I think Mr. Relyea meant in the administration of individual accounts.

COMMISSIONER GRANT: In the absence of any direction in the instrument which creates the trust, they would be bound to act within the confines of the Trust Companies Act, which does contain very drastic restrictions in some provinces.

MR. RELYEA: They have many accounts of the kind I have in mind where they have complete discretion to manage the account and its distribution as between bonds, preferred and common.

COMMISSIONER GRANT: That is the owner's wish.

MR. RELYEA: Yes.

THE CHAIRMAN: You were speaking of taxation, were you not, when you said that before?

MR. RELYEA: I was referring to the restriction which we have on foreign income.

THE CHAIRMAN: As imposed under the Income Tax Act?

MR. RELYEA: Yes.

THE CHAIRMAN: You are not very frequently, I presume, issuing shares and soliciting shareholders.

MR. EMORY: The only way we can do that is in the same form as an ordinary company would. If we issue shares we have to issue a prospectus in the same way as any other company.

THE CHAIRMAN: An open end investment trust prospectus.

MR. EMORY: Yes, but it is more in the form of a permanent prospectus. We have to go to the Securities Commission each time we do it.

THE CHAIRMAN: What is the usual practice of your companies in the distribution of their profits? Do they distribute the entire income or only part? Do they build up a reserve?

MR. RELYEA: We are required to distribute at least 85 per cent, so that the distribution -- we like to have an even number of cents in dividends -- is between 85 and 100 per cent.

THE CHAIRMAN: That is to qualify for the benefits of the Income Tax Act.

MR. RELYEA: Exactly.

THE CHAIRMAN: Should the law be altered to give effect to the recommendations which we received from the people who appeared before us immediately preceding yourselves, their proposal No. 1 would make this a true conduit so that the entire income would be deemed to be distributed anyway. Whether or not it was distributed, it would be taxed in the hands of the shareholders as though it had been distributed. What would be the effect of that in respect of your companies?

MR. EMORY: We could certainly live with that. In fact, I think we would split it very much in the same percentages as the open end fund now.

May I just add one thing. I do not want to give the impression that we are strongly against the conduit system. We have a few reservations. One of our reservations has to do with the fact that a good many of our companies have preferred shares outstanding. If the conduit system is adopted, the company then

becomes a non-taxable Canadian corporation, and I do not know what the position of our preferred shareholders would be with respect to the 20 per cent dividend credit. These shares were issued to the shareholders at the time with the understanding that the 20 per cent dividend credit was in effect. This is not necessarily insuperable but it is a consideration.

THE CHAIRMAN: I would not have thought it insuperable, no. If it was deemed to be a distribution, the distribution would be deemed to be in accordance with the rights of the shareholders. If it were a conduit their rights would be preserved against one another, and I think their rights would also be preserved in regard to taxation. So if they are entitled to a dividend credit for direct investment, they should be entitled to dividend credit on an indirect investment. Whether that is a good way to do it or not I do not know, but your objection to it, apart from preferred shares, would be an administrative one.

MR. EMORY: There is one other possible objection which I can think of, and that is that it leaves the shareholder in the position where until the end of the year he does not know what his tax position is. As we stand now, he knows exactly where he stands taxwise. I can even visualize the position where you might become subject to possible shareholder pressure. In other words, during the year, without prior reference to the shareholders, you decide that in their best interests you should move a lot of money

down to the States, and all of a sudden at the end of the year he finds himself with a heavier tax bill than he expected. I do not know whether that would be a problem, but I can see that there may be a problem there.

THE CHAIRMAN: No, I do not stay with you on that at all. He has entrusted you with his funds and you would be in exactly the same position as would an individual who is looking after another man's funds. He would pay the taxes which would result from the investment of his money in exactly the same manner as he would do had he taken his money to someone else and had them invest it.

MR. EMORY: The difficulty could be overcome by stating something in the by-laws by way of putting a maximum to it.

THE CHAIRMAN: The shareholder, I think it would be fair to say, would not know precisely what his tax liability was until he received his information slip.

MR. EMORY: That is right.

THE CHAIRMAN: I do not know that that is a serious point because he would know roughly what it was anyhow, and would not be making his tax return until he got his information slip. I suspect that a lot of shareholders do not know their dividends until they get their information slip.

MR. EMORY: If the conduit system is to be considered, we feel that within reasonable limits the restriction on investment policy should be relaxed. The

point we are trying to make is that we feel our principal job is to get the highest possible return for our shareholders consistent with the good of the country. We think that freedom of investment action and freedom of capital flow is very important.

THE CHAIRMAN: Let us move on to that point, as to why you feel it is necessary to be able to invest up to 30 per cent of your equity funds -- I suppose it is that -- outside the country. What is the practice now? To keep within the law to conserve the tax position, I suppose. Are you pushing the 15 per cent?

MR. EMORY: As we brought out in our brief, a limit of 15 per cent means, in practice, a limit of 30 per cent as a practical matter. So that it is a little more restricted than it appears on the surface. I think the majority of our members, if given permission, would like to put more money into foreign markets. It is a question of where you think your best return will come from in the foreseeable future. We do not say at the moment that we would want to, but we can foresee the time when, for the protection of our shareholders, it might be desirable or for the betterment of our shareholders. On the other side, we do not want to do anything harmful to the Canadian economy, so we arrive at the conclusion that we would like the maximum freedom possible.

THE CHAIRMAN: Well, that is a fair enough statement. You are here to tell us what is best for your business, although we are concerned about the

whole of Canada when we make our recommendations and cannot ask you to take our position there.

COMMISSIONER PERRY: It is really a question of how severe the conditions should be laid on you on being excuded fromthe additional higher rate of tax which normally applies to a corporation.

MR. EMORY: Yes, that is right.

COMMISSIONER PERRY: I think you have answered this question, but when you speak of room for manouevring, it is not just the casual sort of fluctuation which you might have to encounter in the market situation that you have in mind; it is the possibility of a longer trend toward foreign investments.

MR. EMORY: That is right. There are several factors which might possibly be brought out in our particular type of company, and that is that if we wish to go defensive, as was mentioned in the last submission, we cannot sit and let new money come in. We have to move. In other words, if we did not sell when marketswere heavily overvalued we would have nothing to buy on the market when it is undervalued. This is not to say that we are going to trade, but we have to take steps to protect our shareholders, and one step which can be taken if, for any given reason whatever, it may be that the outlook for Canadian should become not too bright, is to move outside the country. The other step we can take is to move into bonds, but we are also restricted there.

MR. RELYEA: I think our feeling is that our group of shareholders, as a group, should as far as possible be allowed to do everything that an individual investor can do. We realize that there have to be some restrictions to meet some of the government policies, but beyond that that is all an investment trust is, a group of investors brought together to have the benefit of experienced management. We feel that we should be penalized as little as possible.

THE CHAIRMAN: It may be in the interest of the country to impose certain requirements where they can impose and achieve results. It is probably just not reasonable to put them on individual investors. I am not at all sure that the fact that they cannot do it means that they should not do it in places where they can do it. I recognize the point you make, but I will not go the whole distance with you at the moment.

COMMISSIONER GRANT: Is it correct to say that so far as the brief is concerned what you are asking for is contained in paragraph 14? You want 15 per cent of the gross revenue from Canadian sources free.

MR. EMORY: That is correct. Again, if I could refer to the last discussion there was a question asked as to whether, if we had our choice, would we like to be completely free.

COMMISSIONER GRANT: You have not put that forward.

MR. EMORY: No. But the answer is the maximum

freedom we can get which is reasonable.

COMMISSIONER GRANT: You do not think that you are breaking faith with some of your original shareholders if you failed to invest 75 per cent in Canada?

MR. EMORY: That is a serious consideration, and in a great many cases one reason why we would keep the largest percentage of our assets in Canada. Because to the foreign shareholder in many cases he has chosen us as the vehicle to invest in Canada.

COMMISSIONER GRANT: That is a very fair answer.

THE CHAIRMAN: Well, I think the point is clear. When you put the two points together, they would not object to a conduit if you prefer this. I do not think we have great contradictions between what we have heard this afternoon and what we have heard from you. The positions are not irreconcilable.

MR. EMORY: I hope not!

THE CHAIRMAN: Then thank you very much indeed, Mr. Emory and Mr. Relyea. You have been very helpful to us and we are are very glad to have received you.

MR. EMORY: Thank you very much.

THE CHAIRMAN: Mr. Secretary, we will stand over until 9:30 tomorrow morning.

---Whereupon the hearing adjourned at 4:00 o'clock p.m.

ROYAL COMMISSION

ON

TAXATION

HEARINGS

HELD AT

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ROYAL COMMISSION ON TAXATION

Proceedings of hearings held before the Royal Commission on Taxation in the Supreme Court of Canada Building, Ottawa, Ontario, commencing at 9:30 a.m., on Friday, January 17, 1964.

COMMISSION:

Mr. Kenneth LeM. Carter -- Chairman,

Mr. Harvey Perry,

Mr. Donald G. Grant,

Mrs. S.M. Milne,

Mr. Charles E.S. Walls,

LEGAL ADVISERS:

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SECRETARY:

Mr. G.L. Bennett.

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INDEX TO EXHIBITS

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--- The hearing commenced at 9:30 a.m.

THE CHAIRMAN: Are we all ready to proceed? Yes, Mr. Secretary?

THE SECRETARY: Mr. Chairman and Commissioners, the first submission this morning is being presented by the Canadian Shipowners Association. Mr. W.G. Fisher, Managing Director of the Association, is here to speak to the brief which I will now enter into the record as Exhibit 322.

EXHIBIT 322: Brief of Canadian Shipowners Association.

THE CHAIRMAN: Good morning, Mr. Fisher, we are grateful to you for putting in this submission and coming to see us today. We would like to know more about your industry, and we have got a few questions for you, but before we start asking questions is there anything you would like to say?

MR. FISHER: Yes, Mr. Chairman and Commissioners. First I would like to point out that the Association has approached this particular problem with considerable misgivings, primarily because our problems are not exclusively ones of taxation but are ones of national economic policy out of which stem, of course, the taxation relationship as the government of the day so decides or wishes it should be done.

I think you will have noted from the brief that there have been some very substantial tax

benefits given to the industry. The unfortunate part of it is that this feature of tax benefits which have been provided under special legislation of Parliament have been so used or designed to support another industry, and, as a result, we have never been able to make any serious use of the advantages already provided in the tax law.

THE CHAIRMAN: The other industry being building?

MR. FISHER: In other words, the Canadian Vessel Construction Assistance Act provides extremely valuable tax benefits to the shipowner who can use it; but naturally when you have -- and we find this in our own industry -- a lot of benefit which is passing to the industry on a monopoly the benefits are naturally going to flow to the monopolistic industry.

Now, I would also like to develop briefly with you, for a minute, what the theory of the international shipping industry is. I have no doubt you have had many claims made before you for special treatment in special cases and special situations, and in this respect we are no different; but I do think that we are unique in our business in that as an industry our plant, which is our vessels -- this is what we use to provide our service to the public -- has what I choose to term mobility. By the stroke of a pen you can transfer your plant from one country to another country; and in

this aspect we are a somewhat peculiar industry. This has the effect that, in the international field, there is a very large amount of world shipping which lives in corporate domiciles which are for all practical purposes tax free. Canadians endeavouring to engage in this field of private enterprise -- free enterprise -- naturally at least are inhibited by the fact that they are not truly competitive because of the incidence of taxation in Canada which does not apply to their competitors.

I think this is the essence of our problem. In the beginning of our brief I mentioned three inter-related factors -- non-competitive operating costs, non-competitive taxation and lack of risk capital. They are all inter-related. Ten years ago, or fifteen years ago, our biggest problem at that time was undoubtedly excessive operating costs. Today it is a very secondary feature. Our real problem is taxation, and this arises because 15 years ago the capital cost then of a general purpose ocean-going ship was in the order of $600,000 or $700,000; today it is of the order of $3½ million. Therefore, the carrying charges are so much greater. Therefore, it seems to me that the carrying charges on your capital cost overshadow very substantially the amount of your operating costs.

If I may put this in very simple terms, about 12 years ago we did a study on this and the conclusion we reached was that of our gross

revenue approximately 35% of that went into what we might term our operating costs. Using the same basis for your calculations today, gentlemen, it is down to about 12½%. Therefore, if your competitor has much cheaper operating costs the difference becomes much less; and the difference is of the order of 4% or 5%. Therefore, we suggest that with a comparable and competitive tax base the four or five times the operating cost is not difficult to overtake, and it can be overtaken by the greater productivity of Canadians. They are better seamen, and their productivity is greater; and it can be overtaken.

Now, as an example -- and if I may divert the Commission's attention for a minute -- and I am not sure that you will want this put in the record -- but it does illustrate what happens in international shipping as it relates to Canada. This came to my attention in one of the local papers where it told of a 20,000 ton tanker which is now in Halifax. The crew was changed. The Greek crew went off the ship and a Chinese crew came aboard the ship. They found themselves in a great problem because the notices and signs on board the ship were in Greek. The ship was built in Germany and all the instructions in the engine room were in German. Of the Chinese crew of 40 from Formosa only two could speak English. The radio operator, an Australian, could speak neither Chinese nor German

I want to point out how it got into Canadian trade. This vessel was at the time chartered to the Imperial Oil Company; they had it on a long charter. It as built in 1953 in Germany for a Greek firm. Now, they, in their commercial judgment, decided that they were going to sell this ship, and they sold it to a Nationalist Chinese company which set up a Panamanian company where they have no taxes. As I pointed out earlier, at a stroke of a pen the corporate domicile of the ship was changed from Greek to Panamanian overnight. The charter still continues. So far as the Canadian importer of crude oil is concerned he is not concerned with how it comes in as long as it comes in efficiently.

This is international shipping. This is going on all the time; and this is why we may have, and already now have had, to develop the theory of time chartering our equipment; and, to put it in simple terms, we now rent our plant.

With that brief introduction -- I did want to make the point with that anecdote and try to explain what international shipping is.

THE CHAIRMAN: The figures contained in the brief are certainly very startling -- to hear that at the present time 18 Canadian corporate companies own 27 ocean-going vessels whereas in 1948 Canadian companies owned 172 ocean vessels; and as you point out, of course, Canadians charter a great number.

When we talk about 27 vessels, would they be of Canadian registry, or would they be registered under flags of convenience elsewhere?

MR. FISHER: Those 27 vessels are owned in Canada by Canadian corporations and registered within the Commonwealth.

We as Canadians in this field have the benefit of dual nationality under the Commonwealth Shipping Agreement. This agreement, incidentally, was signed at the same time as the Treaty of Westminster and it gives dual nationality so that a Canadian corporation may register its shipping in any part of the Commonwealth; and the converse is also true; and because at this time our operating costs are too high we can get much better operating costs if we register them in Bermuda, Nassau, or the United Kingdom.

THE CHAIRMAN: Thank you.

The Canadian government is not collecting taxes on the income of our --

MR. FISHER: Yes; any earnings on the operation of this vessel come back into the Canadian company.

THE CHAIRMAN: Are there Canadian-owned vessels which are registered in places outside the Commonwealth where taxes do not come back?

MR. FISHER: Very substantial.

THE CHAIRMAN: I would have thought --

MR. FISHER: They do it by being the beneficial owner of another corporation.

THE CHAIRMAN: Quite so; and that is why, I suppose, our Canadian fleet has shrunk to the extent that it has shrunk?

MR. FISHER: To a degree, yes.

THE CHAIRMAN: They have been transferred to non-taxable places and their registration has been transferred to those places and the ownership is under a non-resident subsidiary company?

MR. FISHER: I think that is a fair statement.

THE CHAIRMAN: Well, now, would you have any idea -- and I don't, I must say -- as to how much Canada receives in the way of taxes from the ocean shipping industry?

MR. FISHER: I don't know; I have had great difficulty in getting it. The principal reason is that in the case of ocean-going ships there is no access to the record. I have checked through income tax statistics and they do not segregate ocean shipping from others. Therefore, I can give you no information other than the one statement that is in the brief, which, I think, is quite significant -- on page 4 and page 10 -- where five of these companies -- these five companies decided this year -- in fact, on 31st December last -- to liquidate their Canadian interests; their vessels were registered in the United Kingdom but were owned by the Canadian company. In the last 15 years these five companies have paid $6,610,000.

This is an accurate figure given to me by the management.

THE CHAIRMAN: That is an average of $400,000 a year; and I would assume that has been declining in recent years, following the general trend of Canadian registry.

MR. FISHER: Well, in respect of these particular five companies these were static. In other words, they had the same number of ships 15 years ago as they have now. All that happened was that they had two very profitable years in which they paid very large taxes and then ran into a slump and didn't pay any tax at all.

I think the motives which affected the company this last year were two-fold. The one undoubtedly was Mr. Gordon's last budget in respect of non-resident companies; they could find no Canadians who would take a share; and, secondly, because the industry has suddenly again, after eight years in the wilderness -- has suddenly found itself extremely profitable because of Russian wheat deals; and I think their thinking was, "Here is another year where we are going to pay another $2 million tax," and I think they said"Well, let us liquidate". They have gone to Bermuda and pay no taxes but they still have the vessels. The only difference is the corporate domicile of the companies that have changed from Canada to Bermuda.

THE CHAIRMAN: Well, I would assume that

the ships are still employing Canadians.

MR. FISHER: They are registered in the United Kingdom and employ U.K. seamen.

COMMISSIONER GRANT: Mr. Fisher, going back to the days after the war when we had a lot of liberty ships and when Canada had quite a strong merchant marine, there was a mass sale of those liberty ships away from Canadian ownership; and as I recall it it was due at that time to high operating costs brought about by the high wages which the unions were demanding for the men who manned the ships, and the fact that the higher competitive rates on the international basis did not extend to increased costs; and, therefore, hundreds of liberty ships were sold away from Canadian registry. Would this be basically correct?

MR. FISHER: Not quite. In the initial stages, in this connection, Canada had a very substantial fleet owned by the government built for war purposes. Two hundred and twenty-five of those ships -- which was nearly 80% -- were sold to Canadian companies at that time. They bought them. Some of them were under charter then to the United Kingdom and they were sold to Canadian companies. I would say that that was foreign capital; it was not Canadian capital. But the condition under which the government sold the ships was that they had to set up a Canadiancorporation; but this was foreign capital that came in in the investment.

THE CHAIRMAN: Was this the point, Mr. Fisher, that foreign capital could not own a Canadian ship of Canadian registry?

MR. FISHER: Yes.

THE CHAIRMAN: Each ship still has 64 shares, does it not?

MR. FISHER: Yes.

THE CHAIRMAN: Those shares must be owned by Canadians under Canadian law?

MR. FISHER: Let us define this. You are talking about Canadians as corporations; but don't let us part the corporate veil, because once you do that you open up a whole new area of investigation. The only people who do that are the Americans. An American shipping corporation must be owned by American citizens, but not anywhere else in the world.

THE CHAIRMAN: Under our law do we require Canadian citizenship or Canadian nationality?

MR. FISHER: No. Anybody can come up into Canada and set up a corporation. He can register the ship anywhere in the British Commonwealth; but there is nothing to show as to where the capital came from. We don't look behind the corporate veil.

THE CHAIRMAN: So that you have Canadians who are taking ships elsewhere and registering them in other places?

MR. FISHER: As long as they are within the Commonwealth.

COMMISSIONER GRANT: In the case of Canadian ownership in Bermuda the test is whether or not -- it would depend on where the operating company was?

MR. FISHER: Not the operating company; the domicile of corporation with title to the ship. It may be operating somewhere else entirely. The ship may be owned by a Canadian corporation and it may never see Canada, and be manned in the United Kingdom by United Kingdom seamen. In this case the earnings of the ship must come back to Canada and become part of the taxable income of the Canadian corporation; and these ships we are speaking of -- these ships are in that class.

COMMISSIONER GRANT: So that a company formed in Canada could be an operator of that ship and the only income that would come to Canada would be what that company sent to its parent -- if it were a subsidiary -- to its parent company.

MR.FISHER: If it was a subsidiary, yes; but, of course, we don't operate under that arrangement with subsidiaries.

THE CHAIRMAN: And we don't tax the income from subsidiaries if they are 25% or more; is that right?

MR. FISHER: I think you are right; I think that is correct.

COMMISSIONER WALLS: Are there not other reasons for foreign registry of Canadian ships other

than taxation? Are there not other advantages --

MR. FISHER: Yes; the other advantage is your cheaper operating costs; and they were very substantial ten years ago. I pointed out a little earlier that this differential is substantially narrower. For instance, there is the effect of automation. Crews have been greatly reduced. Your competitive is now able to hire fewer engineers to operate his ships and the costs are higher. That was very evident 10 or 12 years ago when you registered in the United Kingdom. It is not nearly so much today as it was then.

THE CHAIRMAN: Are Canadians not forming companies in Liberia and registering them?

MR. FISHER: Yes, I am quite sure; but I am quite sure that nobody knows how much and how many.

THE CHAIRMAN: But that is happening --

MR. FISHER: Yes, that is happening; and you will find that many Canadians own shares in Panamanian corporations.

THE CHAIRMAN: I know that Canadians are forming Liberian corporations.

MR. FISHER: Yes.

COMMISSIONER GRANT: Could you put us in the picture on another aspect? Let us say a Canadian ship is under foreign registry and is being operated by a Canadian company.

The crew of that ship may be Canadian, or they do not have to be Canadian. If it were under Canadian registry they would have to be Canadians. Right?

MR. FISHER: They do not have to be by law, but they have to be in order to live with the unions. This is the most effective way to comply with Canadian registry, although there is no law requiring that.

COMMISSIONER GRANT: But under foreign registry they can be manned by crews of any nationality. They are then not under any of our Canadian trade unions.

MR. FISHER: I would qualify that with one exception of a British ship registered within the Commonwealth which must employ a British master and a British chief engineer. But on a Liberian ship which may be beneficially owned in Canada through a Liberian corporation you can have a complete Chinese crew on board. As a matter of fact, I was up north one or two winters ago and was quite amazed to see a ship unloading supplies for the mid-continent, or the DEW Line, with the crew hanging over the rails watching the unloading and seeing a sea of Chinese faces. And that was a British ship. Incidentally, they were also British subjects coming from Hong Kong. But it is perfectly legitimate to do that.

THE CHAIRMAN: It seems to me that the ultimate which could be done for you by way of taxation is for Canada to decide to give up

taxing the profits of any Canadian registered vessels which were engaged in ocean trade. I am wondering how much that would cost Canada. Would the cost to Canada and the corresponding benefits to your industry be enough to reverse the trend?

MR. FISHER: There are two approaches to that. In the first place Canada gets nothing out of this so really they will not lose anything by it. After all, you must have something in, some income to give up, but Canada has nothing there. As of now, and particularly in 1965, the tax revenue from Canadian shipping in the ocean-going service is negligible, so you are not giving up anything.

However, I would point out that we do not ask for that in our submission. We are asking for equality in certain sections of tax treatment. If we are to have the benefits of living in the Canadian economy with a Canadian standard of living, I do not think that any of our people are prepared not to pay their share of the taxation which arises from that. But what we would like is to have a certain equality in the taxing division, and we have suggested specific things. One of them is ---

THE CHAIRMAN: Well, we are going to come to that in a minute. But if Canada gets no taxes out of this and gives up that tax, namely nil, the industry would get no benefit from Canada giving up that tax.

MR. FISHER: That is right.

THE CHAIRMAN: Canada cannot do anything more for the industry than give up the tax. That is the ultimate.

MR. FISHER: Yes, that is the ultimate.

THE CHAIRMAN: What I am saying is if that were done -- and whether you wish it or not is beside the point for the purposes of my present question -- would it revitalise the industry? I do not see how it would.

MR. FISHER: Yes, I think it would.

THE CHAIRMAN: If Canada gives nothing to your industry, how would it revitalise the industry?

MR. FISHER: It would encourage these charterers, the people who now are the renters, to return to ownership.

THE CHAIRMAN: Yes, that makes a point.

MR. FISHER: Ten years ago they were the owners.

THE CHAIRMAN: They are really chartering their own vessels which belong to their foreign subsidiaries.

MR. FISHER: Yes, that is true in part.

COMMISSIONER GRANT: But their operating costs would rise if they returned to Canadian ownership, would they not?

MR. FISHER: Yes.

COMMISSIONER GRANT: But you think tax concessions would offset that, do you?

MR. FISHER: No, I do not, but I do

not think that the operating costs would rise sufficiently to inhibit them from doing that. I say this because we believe that under current conditions Canadian operating costs are certainly higher. However, the productivity factor of Canadians is far superior to that of the seamen we get for less wages. I think the one offsets the other.

COMMISSIONER GRANT: Plus the fact that ocean-going rates are much higher.

MR. FISHER: Yes, although there is no guarantee that that will prevail.

COMMISSIONER GRANT: There is a great fluctuation there.

MR. FISHER: Yes. On your operating cost theory, I might say that we can man a 12,000 ton bulk dry carrier, one of the standard ocean-going ships, with 32 to 34 Canadians. In the United Kingdom they have to have 45. If we go to China we must have 52. The wages are much lower, but by the time you feed the men, provide housing accommodation for them on the ship, and so on, the differential is very narrow.

COMMISSIONER GRANT: How do the loading facilities affect the operating costs?

MR. FISHER: When I speak of operating costs I am exclusively speaking of ship cost, because the cost of loading and discharging, and all the other things which go into it, is common to all ships. They all pay a common charge. But

a Canadian ship operated with a crew of 32 or 34 men, if you had a crew of Chinese on the same ship you would need 50 men.

COMMISSIONER GRANT: I do not know why that should be. I am sure Canadians would not do three times the work of Chinese. Is it because the facilities are better?

MR. FISHER: Yes, they are better, and there is better maintenance on the ship.

COMMISSIONER GRANT: Canadian seamen are more productive per man than British seamen, are they?

MR. FISHER: In our view the Canadian seaman is the most productive in the world, in our experience.

COMMISSIONER PERRY: This might sound like a silly question, Mr. Fisher, but I gather from what you say that the essence of a strong Canadian shipping industry would be to have ships owned by Canadians and manned by Canadians, and presumably carrying Canadian goods in addition?

MR. FISHER: That is the essence but it does not follow that those ships have to be built in Canada, although that would be desirable. This has been our problem for the last ten years, that if we want to develop a Canadian merchant marine and to get the advantage of the tax scheme, they must be built in Canada. Until the shipbuilding subsidy introduced by the government two years ago, the costs of this were out of the question.

COMMISSIONER PERRY: I deliberately left out the price of registration. Is that relevant at all in the ideal concept of a Canadian shipbuilding industry?

MR. FISHER: That is a very debatable point nowadays. Some 20 years ago registry was an important factor. Today registry is not an important factor. It is not nearly as important, particularly as most of the world is doing what we are doing, going into the business of renting rather than owning equipment.

May I just give you an instance to demonstrate this point. One of the best known facts is that the British Mercantile Marine is the finest in the world. It has not increased in size in the last ten years comparable with the development of the volume of world trade. It is practically static. Today they are very substantial renters of equipment, the same as we are, to such an extent that ten years ago they had a surplus in their balance of shipping payments and their balance on international accounts in the order of $34 million. In 1952 they paid $350 million to rent ships and have a deficit on shipping in their balance of international payments to the United Kingdom to the extent of about $49 million. This is the pattern of the business.

Now, we are doing the same. We chartered roughly 400 ships in 1952 and carried 25 per cent of our total external trade, import and export, which gave us a $90 million

deficit in our shipping account.

THE CHAIRMAN: To some extent that deficit, I would assume, would be offset by dividends paid from the foreign subsidiaries owned by Canadians. I would assume a great deal of this chartering is simply tax evasion.

MR. FISHER: Yes, tax evasion, but in practice they do not bring the money home. They use the money to plow it back into the business and get newer, bigger and better ships. Very rarely are the profits brought home, they are plowed back into the industry. They get their reward out of it by appointing a $20,000 president, a $15,000 vice-president, and so on. They do not have to pay dividends because they can extract their earnings out in other ways.

COMMISSIONER GRANT: Your plea, Mr. Fisher, on behalf of the owners of ocean-going ships ---

MR. FISHER: Well, I would put it in this way, that my plea is on behalf of the operators to encourage them to keep ---

COMMISSIONER GRANT: To return their registry to Canada?

MR. FISHER: Or to return from the basis of a renter to an owner. Not necessarily a return to Canadian registry; it could be a Commonwealth registry. But my plea is to create the kind of economic climate in Canada which will encourage the operators of these 400 chartered

vessels seriously to contemplate owning them rather than having to rent other people's equipment. Then the real benefits will flow to Canada because we can then employ Canadian seamen. The revenues of the industry will start to flow back into the country.

THE CHAIRMAN: I have read your submission and I am wondering whether the recommendation in paragraph 16 would accomplish this. That is why I said to you that if there are no taxes out of it, why bother to remit all the taxes on Canadian owners and vessels.

MR. FISHER: I think probably the way you have put it indicates that we have been a little reluctant to come before you and to say: "Look, we cannot have taxed capital so we have suggested certain measures and they will go a long way".

THE CHAIRMAN: Well, let us look at them. There is a request that the recapture value be held for investment for a period up to ten years. Is that right?

MR. FISHER: Yes.

THE CHAIRMAN: On the ground that if that were done it would probably not be recaptured and the additional taxes paid on it would be used for further capital expenditure. That does not affect the overall amount of depreciation charged over a 25-year period. I suspect that it would be pretty much the same. True, it would

be in and out, and so on, at a different value, and the taxes would be paid earlier, as things now stand, than what you propose. There would be deferred payment of certain taxes.

MR. FISHER: I wonder in respect of recapture. I may be guilty of trying to over-simplify it, but most of our ships today have probably a written down book value which is probably negligible. They are about 15 years old and would probably be written off by now.

Years ago they were worth \$50,000 to \$70,000 as scrap. Today we can sell them for \$200,000. But if you do not reinvest that money and the original ship cost \$600,000, say, that \$200,000 has to be taken back in taxable income in the industry. Half the benefit of the inflationary value of the thing is returned to the government. The owner says: "I want to keep that to reinvest it, not necessary next year, but when my commercial judgment tells me to do so." In the meantime, he says he will rent a ship.

I suggested ten years ago that that should be done, as it is done in Norway and the U.K. I am not sure what they have, but they do have much greater benefits in what they call their balancing charge. They hang on for a long time before they have to account for it.

THE CHAIRMAN: Well, we will look at that and see.

COMMISSIONER GRANT: You say that a

ship is in a different position from a building, for instance as far as depreciation is concerned, in that in a building you may renew parts and make capital expenditures. But what is your chance of making capital expenditures on a ship? I suppose its engines must be renewed every so often, and so on?

MR. FISHER: The average life of a ship is 20 years. Maybe it will run to 25 years. If you keep it in a restricted trade, you can even get 30 years out of it. This is an ocean-going ship. It is different on the Great Lakes, where they are not affected by salt water. There they can go for 50 years because there is less deterioration. Also you can convert a ship and jumbolise it. For instance, they now cut them in half, so to speak, and put in an additional 100 feet in the centre of it, which will double its revenue-carrying capacity. But the life of a ship will not be more than 20 years, because the cost of maintenance and repairs becomes so great that you might as well scrap the whole thing and start all over again new.

THE CHAIRMAN: Well, I am conscious of the fact that your industry needs help.

MR. FISHER: I am not suggesting for a moment that we are any different in respect of that factor, but with a plant you can normally bit by bit replace, improve, and so on. For example, you have the land, which is part of your

value, which you have not got with a ship. Furthermore, the whole ship must be replaced. Another factor is the question of improvement. A ship which is built today is a far superior ship to anything which we had a few years ago. But you cannot bring an old ship up to the standard of a new ship. You have to scrap it and start entirely new again.

THE CHAIRMAN: Ships have been used to demonstrate the need for depreciation based on replacement costs rather than on old costs, because, as you say, you have to replace the whole thing and because your replacement costs seem to go up with the age of the vessel. This argument has been put forward many times with regard to ships. This would change the whole system, and one could not very well embark on that with ships without embarking on that with other things too.

MR. FISHER: We realize that.

COMMISSIONER PERRY: Is it not true that the first effects of this proposal would be to make it easier to sell ships?

MR. FISHER: It would encourage the operators to sell their old ships. By the same token, if they can find a profitable sale and have got the money in, they do not have to spend it for a given period of time. They keep the capital intact.

COMMISSIONER PERRY: That would be the ultimate hope, that they sell it and use the money later on for reinvestment.

MR. FISHER: One of the factors which induced this plight of Canadian corporations this year is that they were going to sell the ships and they did not want to be subject to recapture of their capital cost. They will go back nearly to what they paid 15 years ago. Ships have nearly tripled in value during the last six years.

THE CHAIRMAN: Will this not shrink our fleet still further? Will we not get rid of the idea of 27 ships with this recommendation?

COMMISSIONER PERRY: I was talking of the immediate case.

MR. FISHER: Not entirely so. It would deplete our shipping further. Let us say that our fleet had shrunk right out. What have we left then?

We have eight or ten large operators chartering 400 ships. These are the people who have to be encouraged to come back to being owners. This is the point. We might very well forget these other boys. There again, this is not quite true; they are intermingled. There is one company, in this connection, chartering a fleet of 45 or 50 ships. They use the device of manning and operating these ships with Canadian crews, to get around this, but they are all Liberian or various odd registries outside Canada. They are just an integrated part of his fleet.

THE CHAIRMAN: I find the recommendation a little curious, as has been brought out by Mr. Perry's question, namely, that this recommendation will be more attractive to the sale of vessels, whereas it is in the national interest to encourage the retention of vessels.

MR. FISHER: I would put it this way. It is in the national interest to set out the kind of provision that will encourage people to own vessels, and if those same conditions apply, I think those that are left will probably remain.

COMMISSIONER PERRY: I would accept that this does set up a more favourable climate for the ownership of ships in Canada, although its immediate effect would not be this, would it?

MR. FISHER: May I just discuss that for a second. Under Section 20, where the recapture

provisions apply, if this was listed for ships in the next budget these fellows would be encouraged to sell their ships, and they would sell their ships for a high price. But it does not say they would flee the country before they sold the ships. They would tend to keep the capital here, and the inflated capital, because it is inflated capital.

But I do not think it follows that they have gone because of the present conditions. If we corrected these conditions, they might be tempted to stay.

THE CHAIRMAN: That may be so, but the point I am trying to look at is, would this serve the pockets of these people? Would it not best serve their pockets under this condition to proceed further with what they are now doing; that is, to sell their ships to their wholly-owned Liberian subsidiaries, take recapture and have it deferred for 10 years and leave the ships in Liberia, where they are not going to be taxed?

MR. FISHER: That is true.

THE CHAIRMAN: I would have thought this would have served their purpose best. There will be, perhaps, many Canadians who would say, "This is not right. We want the ships in Canada", and so on; but that is beside the point we are speaking about.

MR. FISHER: That is perfectly correct. Looking at it simply from a straight question of cause and effect, there is no advantage at all in having

a ship owned in Canada at the present time.

THE CHAIRMAN: I know that Bermuda is attracting more and more ships. The Bermudians think this is a wonderful business. They have over 500 shipping companies, or something of that kind, operating there.

MR. FISHER: Now, they have eight more, as of January 1, 1964, from Canada.

COMMISSIONER GRANT: It would seem to me a very strong point in your favour, under Section 20 in regard to extending time under which the recapture depreciation may be used on the purchase of another vessel, is due to the fact that ocean-going rates fluctuate to a great extent due to war scares or other causes.

We have a sample of it right now, where every vessel is in demand to ship grain to Russia, and therefore rates are naturally increasing over what they would be in an average year. A person who wants to go out and buy a ship today and take advantage of the recapture depreciation is under a distinct handicap, whereas if he could hold out for two or three years he might be able to replace his ships at normal cost.

MR. FISHER: That is true. On this point, Mr. Chairman, I have a table. If it is of interest to the Commission, I have prepared a table on the distribution of world-wide ownership of international shipping which indicates the volume

that is being held in tax rebate jurisdictions. This may be of interest to the tax commission.

THE CHAIRMAN: Yes.

MR. FISHER: I prepared this to substantiate the statement I made here. I said "many countries", but I did not give you any facts to back that up. So to correct that situation I have prepared this table, which was taken from Lloyds Register. At least, that is the source of the figures.

THE CHAIRMAN: Thank you. I have been under the impression that all ships have been running like mad for countries which give these tax concessions.

I think Mr. Perry is about to raise the point as to whether this is not more a trend to rental than it is to ownership.

COMMISSIONER PERRY: I was just wondering whether the trend which you detect in the industry generally towards renting, and thus avoidance of any problems of ownership, maintenance, negotiation, and so on, may not be extending to shipping as well, and whether this might be part of the explanation, at least, for the greater tendency to rent rather than own?

MR. FISHER: I agree with you. There are some difficulties, of course. While the corporate tax free jurisdictions have tremendous attractions, they also have fairly substantial disadvantages too. One of them is the incidence of the flags of convenience and the attack of the international labour unions against them because

they lose control. Two years ago we had a strike in the United States, when they boycotted all these ships. Your tax benefits on the one hand can be dissipated by a week of that and the extra costs involved in having your ships tied up. So it is not all gravy by any means.

These operators would much prefer to own their equipment, if they can, rather than rent somebody else's equipment. There is great satisfaction in owning and operating in the way you want to, not the way the other fellow wants to. This is their life-blood, and so on. So it is a difficult thing to pin down; it is intangible. But there is certainly a desire to own your own equipment. If you look at the situation in the United Kingdom, this is borne out.

THE CHAIRMAN: Would you explain this table to us, Mr. Fisher?

MR. FISHER: Yes. I had better get the copy back. I mention in the brief "many countries" with regard to this question. I took the world's ocean shipping of 4,000 tons and over, which is an element to sort of eliminate all the little ships. These 12 countries listed here own 72 per cent of the total of the world's shipping of 4,000 tons and over.

I break the 72 per cent down as between these 12 principal countries and then, just on a percentage basis, I show that three countries Liberia, Greece and Panama hold 24 per cent of this total. These three countries are considered

to be basically corporate tax free.

Then I say that eight of the countries -- all others except France -- provide special tax measures for their ocean shipping enterprises. The purpose of that is simply to establish the fact that most of them give assistance to their shipping. I hope this will demonstrate that fact. That is the only purpose of the table.

THE CHAIRMAN: Does Greece not tax their shipping industry?

MR. FISHER: Not the ocean-going shipping industry. They repatriated that in the last ten years. They came back to the Greek flag on the undertaking that they would not pay tax for eight or ten years. There is a bill before the Greek Parliament now to extend that for another ten years, because the owners started to flee the flag again because they lost their tax benefits.

There is a great money market that flies around the world and tries to get what they can get; witness Mr. Onassis and Mr. Niarchos.

COMMISSIONER GRANT: What benefit would these countries that give these special tax concessions derive from the registration, other than a registration fee?

MR. FISHER: It is a straight registration fee, and then they get an annual tonnage tax, which is a fixed tax, very small.

THE CHAIRMAN: Bermuda gets £200 a year, I think.

MR. FISHER: I think so. Liberia extracts four cents a gross registered ton a year, but you register your ship in Liberia and they give you an undertaking that it will not be changed either up or down for ten years. The Panamanian registry is not so attractive because one of the provisions laid down is that you have to employ Panamanians. There are not enough Panamanians to go around, and this provision is rarely operated. But now and again the Panamanian counsel comes along -- and you have to pay a very high fee to get your articles signed -- and he says, "I have two Panamanians over here that you have to take on", and the owner has to take them on to get his ship going.

THE CHAIRMAN: Bermuda issues a certificate to the effect that you will not be subject to profits tax for 20 years, I think.

MR. FISHER: And Nassau has the same thing. It is a lovely place to be for the owner.

THE CHAIRMAN: Moving on to section 20 (5) (a) which exempts insurance proceeds from recapture, and so on, you really say the same thing in regard to that, do you not?

MR. FISHER: Yes, exactly. That is the same thing.

THE CHAIRMAN: Then with regard to the carry forward of losses, you would like that extended for a longer cycle?

MR. FISHER: This, to us, is the

most important thing in our present recommendations, under our present conditions, which we would like to extend indefinitely, which is the practice in most countries.

In the United Kingdom, for instance, you can carry it forward indefinitely. Almost all our competitors have the same provision. The reason is that you have peak years with tremendous profits, and then you have long periods when you have either losses or marginal profits. If you cannot carry losses forward and deduct them, you lose the benefits, of course. In that respect we are non-competitive, and very much so. This is most important.

COMMISSIONER WALLS: Do I understand you to say that most countries carry it forward indefinitely? Would it not be the United Kingdom only that carries it forward indefinitely?

MR. FISHER: They do for shipping purposes.

COMMISSIONER PERRY: You may be arguing that for shipping purposes only they carry it forward indefinitely?

MR. FISHER: This is all I am arguing.

COMMISSIONER PERRY: Because in the United Kingdom this is a general provision for all business.

MR. FISHER: Is it?

COMMISSIONER PERRY: Yes.

MR. FISHER: I understand it to be so for shipping. I do not know about other things.

COMMISSIONER PERRY: There is not a special concession for shipping in the United Kingdom; it is a general provision.

THE CHAIRMAN: What we have here may not be correct; it may be a general provision and not just applied to shipping. The information we have is that there is a special provision for shipping and we are informed that France allows five years, and Germany, while Denmark allows losses to be carried forward for two years, and with Greece it is two years. That may be for general business, or for shipping; we do not know.

MR. FISHER: Yes.

THE CHAIRMAN: Then with regard to Section 27(1)(e) you say that you attach great importance to this carry forward of losses?

MR. FISHER: I do, and I feel that this should be carried forward against future earnings indefinitely. If there is this provision for businesses which are privately operated, this will permit, I hope, particularly if you couple it with the tax reserve, those operators running ships today to have a little fat on their bones.

THE CHAIRMAN: I do not think we need concern ourselves with Regulation 105(1). It seems to me that is a matter which might be drawn to the attention of the authorities. But they are carrying on a regulation which they impose upon all non-residents coming to Canada.

MR. FISHER: I agree.

COMMISSIONER WALLS: Are these gratuities paid in all foreign ports which ships enter, or is this a Canadian practice?

MR. FISHER: This is a world-wide practice. I might just take this opportunity, if I may, to say a word about this. The word "gratuities", which is a trade term and everybody understands it, is not quite right in this context, I do not think, because they use the money to pay expenses also.

As you know, they entertain aboard the ship; Customs Officers come on the ship and have to be given a drink, or coffee or something of that nature. This is all part of that. But at least it is paid in cash. Maybe I should not have made that statement either. I am going to get trapped here if this evidence ever gets out.

COMMISSIONER PERRY: Do you know whether this is allowed as a deductible expense to the person making the payment?

MR. FISHER: Yes, I think it is. I think it is a deductible expense. I have never really asked that question, but I believe it to be so.

COMMISSIONER PERRY: It is quite an interesting pcint. I happen to know that it is, but by rather a special ruling of the Department.

MR. FISHER: It is not an important factor and I do not stress it. I was asked by one of our members to bring it up.

THE CHAIRMAN: With regard to capital cost allowances, you would like the choice to diminish

your balance or straight line?

MR. FISHER: Yes, which is the practice in the United Kingdom.

THE CHAIRMAN: You say:

"The reducing balance method does not allow complete write-off."

That is, of course, true. Then you say:

"Accelerated depreciation, in any event, is no more than a postponement of potential tax liability until a greater part of initial capital costs are recovered from earnings."

I would have thought that when you were directed to carry forward and recapture you might stay with the diminishing balance.

MR. FISHER: That is true. This is why I suggest the alternative. Let them make their choice.

THE CHAIRMAN: The people that do use straight line now avoid recapture. You are not contemplating that, are you?

Farmers are entitled to use straight line depreciation, and also their assets, when sold, do not produce recapture. They avoid the recapture provisions. You are not suggesting that, are you?

MR. FISHER: I am not sure. I did not even know that was possible.

THE CHAIRMAN: I am giving you an idea.

COMMISSIONER WALLS: If they did, that would solve the first problem.

THE CHAIRMAN: It would solve the first problem, but putting it around the other way, it does not solve the second.

With regard to shipping, I think the loss of revenue would be pretty substantial. Thank you. We will consider that.

You have pointed out that the effect of the Canadian Vessel Construction Assistance Act has not been useful to your industry, and I think you indicated that the benefits of that Act are not passed on to you, meaning, I think, that the construction costs of the ships are not reduced to the extent to which you think they should be reduced. Is that right? You spoke of this not benefiting the industry.

MR. FISHER: Up until two years ago, when they brought in the shipbuilding subsidy, the cost of shipbuilding in Canada far overreached any of the advantages to be gained by the operator. Consequently there has just been no incentive. There have not been enough incentives to Canadian operators to order ships to be built in Canada. I think the tendency has been -- I am not making this as a categorical statement -- that the shipbuilders say to the operator, "Sure, we will quote you this price, but look at all the benefits you get". This is our objection to it, that we cannot take those benefits and go some place else and seek a competitive market. We are restricted by the use of the benefits.

COMMISSIONER WALLS: Is it not a fact that this new subsidy that came into effect two years ago

C-13 has brought the cost down relatively in line with British shipbuilding costs?

MR. FISHER: Yes.

COMMISSIONER WALLS: Then why do you prefer to go to the United Kingdom when you can do it for a like figure in Canada?

MR. FISHER: I do not want to cross that bridge because we have not built any ships at all in the last two years.

If there was a revival of interest in Canada, I would suspect that the Canadian shipyards might be competitive. Of course, they are not competitive now, I do not think, even today. The subsidy of 40 per cent was on for a while, but it has reduced to 35 per cent now. But I do not think -- as far as I know, at any rate, there has been no interest in building ships per se by the Canadian operators at this time. If there is a revival of that interest by one device or another, that may help the situation.

I think one of the things that has inhibited us is the lack of risk ckapital. You can go to Japan, for instance, and build a ship today just as cheaply as you can build it in Canada. You can register it in Liberia. The Japanese will give you a ten year term at 4 5/8ths per cent interest, which is unbeatable in the industry.

THE CHAIRMAN: Thank you very much, Mr. Fisher, for helping us in this problem. We will continue to concern ourselves with it. It certainly isn't easy to see how with any taxation device one can make laws which would be attractive to prevent our ocean ships from going elsewhere; but, as I say, we will certainly continue to give it thought.

Many thanks for appearing today.

MR. FISHER: Thank you very much.

THE CHAIRMAN: Mr. Secretary, we will recess for ten minutes.

--- Recess.

SUBMISSION BY CANADIAN CONSTRUCTION ASSOCIATION.

APPEARANCES:

Mr. T.A. Somerville

Mr. M. Stein

Mr. G. Moller

Mr. T. Gray

Mr. E. R. Graham

Mr. S.D.E. Chutter

Mr. K.V. Sandford

THE SECRETARY: Mr. Chairman and Commissioners, the second submission this morning is being presented by the Canadian Construction Association.

Mr. T. A. Somerville, Toronto, President of the Association, is here this morning with some of his associates and will speak to the brief and will

introduce his associates; and I would like to enter this into the record as Exhibit 323.

--- EXHIBIT NO. 323: Brief of Canadian Construction Association.

THE CHAIRMAN: Good morning, Mr. Somerville and gentlemen. We are glad to see you this morning. We have received your submission which I have found very interesting, indeed. We have had an opportunity to read it. There is no need to do so again. We will have questions to put to you.

I certainly thought that you covered a lot of territory, and I am glad that you stuck to the matters which concerned your industry. I must say it seemed to me a most happy illustration to be able to explain the difficulties of sales tax by the bridge just outside here, that you can almost see. It made it very clear indeed to me.

Sometime we ask our counsel to assist. This depends upon the technical content, and so on. In this case you have gone into technicalities fairly deeply, and we will ask Mr. Coyne to ask questions. This will not exclude us from questioning you, but I would like Mr. Coyne to deal with this main question.

Before we proceed to the questions have you anything you would like to say ?

MR. SOMERVILLE: Yes, Mr. Chairman, Mrs. Milne and gentlemen: First I would like to introduce our group. The Chairman of our taxation committee is

on my left, Mr. Stein, who is Vice-President of Magil Construction Limited, Montreal; then the Vice-Chairman of our Committee, Mr. George Moller, who is Vice-President of Robertson-Irwin Limited, Hamilton; Mr. Thomas Gray, Secretary-Treasurer, Pigott Construction Limited, Hamilton, who is on the left here; and Mr. Eric Graham, Treasurer, Pilkington Brothers (Canada) Limited; and our staff members here today -- Mr. Chutter, our General Manager, and Mr. Ken Sandford, our Taxation and Business Research Officer; and Mr. George McNay at the back, our Public Relations Director.

I would just like to say a word if I may. Members of our industry have had cause to be especially conscious of tax matters, as you can imagine, in recent months, and we are very pleased to have the opportunity of presenting our views to this Royal Commission. We have endeavoured to concentrate in our brief on tax matters as it affects our own operations and those of our clients, which is most important, because they make the capital investment decisions that bring our business to us. We shall be very pleased to endeavour to expand on any of these matters that are in the brief, and I have men with me who have a wide knowledge of the particular problems to our industries and who are here for that purpose.

Thank you, Mr. Chairman.

THE CHAIRMAN: Thank you, Mr. Somerville.

Mr. Coyne, will you now proceed?

MR. COYNE: Thank you, Mr. Chairman.

Mr. Somerville, I wondered if we could start with some discussion concerning some of the general or summary paragraphs that you include in the first part of your brief, even although many of these points are picked up in more detail in the later parts and we may have occasion to refer to them as we go through the later parts of the brief.

I would invite you to turn to page 4, paragraph 8. In this section you are dealing with some general principles. In the first sentence of that paragraph you state:

"Taxation policies should make a clear-cut distinction between capital goods and consumer goods".

I wonder if you would explain, in a little detail, what you mean by this distinction, bearing this in mind, that in what is perhaps normal trading there are many consumer goods which are also, at least in some sense, capital goods. For example, I suppose an automobile is a capital good, a washing machine is a capital good, in the sense that it is not immediately consumed. Now, coming closer to your own field, I suppose a house is in a sense a consumer capital good.

Would you care to expand a little on this distinction that you state here?

MR. SOMERVILLE: I think the basic thinking, if I may say so, is that capital goods

are those those things that are purchased by our clients and become capital expenditures in their hands; because anything that goes into a building becomes capitalized.

THE CHAIRMAN: You are not distinguishing between consumers' and producers', I take it? Mr. Coyne was ---

MR. COYNE: That was to be my next question, Mr. Chairman -- whether it would be fair to paraphrase the distinction as being between production goods and the consumer goods.

MR. CHUTTER: I think that the Committee would like to include the capital outlays by business enterprises, but also including a house, which, in effect, is a capital expenditure by the home owner and is a permanent fixed asset as such. It is, to the largest capital outlay of many individual families.

MR. COYNE: Well, then, Mr. Chutter, would it be fair to say that the distinction you are drawing here is between capital goods plus houses and consumer goods less houses? I put it to you, for example, that an automobile, so far as the consumer is concerned, is in capital goods. there are many variations of degrees, but it is a capital good; but I take it in this context you would include an automobile as a consumer good but a house as a capital good?

MR. MOLLER: I would suggest that perhaps this distinction should be drawn closer to the

subject at review and that is taxation. Anything which is classified in a taxpayer's balance sheet and profit and loss account as a fixed asset would be perhaps best considered a capital good; and the only capital good in non-producers or non-business enterprises, I would consider, that fall into this category would be ---

THE CHAIRMAN: What about furniture?

MR. MOLLER: Well, it is not as important in the first place, and, in the second place, it is not as long-lived; but perhaps we should admit that any clear-cut distinction even between fixed assets and current assets, from an accounting viewpoint, is rather misleading.

THE CHAIRMAN: I think so.

MR. COYNE: I may have occasion to revert to this aspect, but perhaps we can pass on for the moment. I think you have made the idea you have in mind quite clear.

Proceeding now to paragraph 10 ---

COMMISSIONER PERRY: Mr. Coyne, could you ask the witness why he wants this distinction made, or maintained? I think myself they have given one reason in paragraph 9 which they might cite, but I wonder if there are any other reasons.

MR. COYNE: Mr. Perry has asked a question. Would you comment on it?

MR. CHUTTER: I think the idea in the minds of the members is that capital outlays as we have described them, do contribute to the expansion of the

economy, and the general economic growth. If you build a new factory, or a structure, or a means of transportation you help in the expansion of our country and it is an investment in the future, if you will; whereas the other type of outlay has already been made and it is consumed and it doesn't have any real durability or make a contribution to the economy and is without emphasis on the need for development of the economy. I think we feel that this distinction should be made in the tax laws.

MR. COYNE: Of course, the distinction is perhaps quite clear when you mention a factory which, one might say, perhaps, is no different in its way from the machinery and equipment which is installed in the factory; the whole plant is production goods. But when you get back to the question of houses, then, could not the same statement be made, for example, by the automobile industry with respect to automobiles. Automobiles are things which are of a capital nature in the sense that they are not immediately consumed, and they are bought essentially for consumption, purchased by consumers.

THE CHAIRMAN: I wonder if it isn't a little dangerous to pin this down in the way that it seems to me that you are trying to do this. I would have thought that we might simplify this by trying to get to the details.

COMMISSIONER PERRY: I think, briefly, the witness's position is that they are on the side of capital expenditure. Not all economists are.

MR. COYNE: Could we just go down to paragraph 10, where you refer to:

> "A largely hidden but very real cost factor related to the multitude of taxes in various forms collected by the three levels of government in Canada is the heavy overhead burden borne by businesses in the keeping of records, making of payments, claiming of refunds ..."

et cetera -- and you refer to that same position again in more detail on page 22 in paragraph 53 and 54.

Has there ever been any attempt to estimate what the cost of this collection and record making is, particularly in the construction industry where it is so extensive because of the complexity of the industry in all levels of goods and in many special types of taxes and imposts.

MR. SOMERVILLE: I am going to ask Mr. Moller to deal with this question in relation to manufacturing contractors, and I am going to ask Mr. Gray to talk in relation to the general contracting field, if I may.

MR. MOLLER: If I may I would point out that we have been, since June 13, under the terrific impact in the administration of sales tax which obviously, in our relatively middle-sized enterprise with about 900 employees immediately required the assignment of four new positions in the company because

of the imposition of the sales tax on building material.

In any attempt to assess the real cost you would have to take into account particularly the terrific amount of time spent -- and, I must say, partly wasted -- by top management people and top financial accounting people in coping with the problem brought about by the imposition of this tax. I could show the Commission, and then submit it subsequently in writing, the maze through which one has to wade these days in order to estimate the sales tax on any specific construction job. We are on a lot of jobs and we have to estimate the sales tax impact on each job, and we have devised a form which is very complicated. It goes from "A" to "T" points, which have to be calculated mainly because of the impact of the taxes, taking into account the provincial sales tax which is imposed and the sales tax exacted by the Dominion Government. So if you don't know the Dominion Goverbment's tax exactly it is almost impossible to calculate or estimate the provincial tax; and you can't calculate the federal tax because the basis of the federal tax depends on the cost of the material at the time you buy it.

The complexities are really, in my opinion, still not clear to many of our contractors; and those who have had to elaborate the accounting systems are faced immediately with having to calculate the costs and they run basically into the same difficulties which anybody in the administration or who are indeed

engaged in measuring the efficiency in an office which is almost an impossible tax.

But certain things can be seen because they are quite obvious, such as the complication in estimating, the increase difficulty in doing business and, as I said before, the amount of time and effort on the part of people who should be concerned with innovations in business, with producing new products, or promoting new products or other methods of production and which, I would say, are sterilized to the point that they divert all their energy to cope with tax impositions.

These are the things which aren't even clear to the people who have to administer the tax. I could give you almost dozens of examples where, between June 13 and even now, the attitude of the Department of National Revenue had changed not once or twice but three times concerning the same points in the sales tax imposed on building materials.

I think that by and large the public is not aware of this almost unbelievable confusion.

I was just handed yesterday a new explanation on structural steel components, which now, in fact, tells us what we should have done in August of 1963.

MR. COYNE: May we return to some of the detailed aspects you have mentioned when we come to the sales tax section itself. Let me ask you one important general question. To what extent are the complexities or difficulties to which you refer, particularly in estimating cost per job, the result (a) of the novelty of the tax, the fact that it is new and that even the Department have not been able to work out the details of it effectively, and (b) the result of this transitional period where the tax is to go up in stages? Are those the principal sources of the difficulties, or will these difficulties you refer to remain after the tax has ceased to be novel and this transitional period is passed?

MR. MOLLER: Sales tax at all times was a difficult subject. I think no one will deny that, even the Department of National Revenue. But the combination of sales tax and construction is something like two elements which do not mix. This marriage, I think, will never work out because, speaking particularly from the viewpoint of the manufacturing contractor, the division between the manufacturing part of the enterprise, which is the only part subject to this imposition, and the construction aspect which is not subject to the tax is the same combination which, dependent on the organization of the enterprise, must lead to discrimination or very bad inequalities and inequities between the individual firms engaged in the same line of business. This on-site and off-site manufacturing has many other aspects.

Regulation 22 and 23 dealing with the

application of manufactured products in itself was always a difficult one to handle, but as long as it applies to appliances like TV sets and other things could be coped with. Because the magnitude of the expense for the material part of the job made the application or installation cost relatively unimportant.

This is not the case with construction material, because you can find, for example, wall panels being constructed right in the plant complete, or you can ship the components to the site and put the outer shell and the inner shell and the fibre glass insulation together at the site, in which case you pay tax on the cost of the individual component.

An attempt has been made to offset that, not with wall panels but with floors and decks, for instance through adjustments in the budget; but I think it does not cope with the intrinsic difficulty of keeping manufacturing and direction apart. This is the thing which will not be avoided by getting familiar with the regulations or building them up, because I am afraid that we are getting to more and more exemptions or into more and more inequities.

MR. COYNE: Thank you. There are many aspects to Mr. Moller's answer to which I think we will want to revert, Mr. Chairman, but it might be preferable to leave them now.

THE CHAIRMAN: Mr. Moller, I was about to say, was giving us a very full answer indeed, but while we are being general now we will, of course, come back to this when we are specifically on sales tax.

MR. GRAY: In connection with the general contractors, perhaps I might say that we have not quite the same problem as the manufacturer. In fact, we have no connection with them really. However, we do have such things as income tax deductions, unemployment insurance, vacation pay, sales tax, dominion and provincial. We also have sales tax on machinery, for example, which we buy in Ontario to ship to Quebec. You must pay provincial tax in Ontario and you must pay provincial tax in Quebec.

MR. COYNE: Would you say that there are additional charges which you bear over and above what ordinary businesses may bear -- this is the point you are making now -- because of your mobility of moving from one jurisdiction to another?

MR. GRAY: Yes, we have. Possibly I should say that I have been in business for about 17 years, and during that time, when I first started we used to have a rule of thumb that one man on the job could handle about 250 men. Nowadays they are lucky if they can handle 100 men with all the putting of stamps into books, keeping track of income tax deductions, unemployment insurance and so on. Then in the head office there is the usual increase in the staff. At one time we used to have two people on the pay roll, but we now have five.

MR. COYNE: But you have not made any actual study in detail or any attempt to determine what the level of costs in these factors are; you rest on this general statement?

MR. SOMERVILLE: Not in dollars, no.

MR. MOLLER: I would say that the imposition of sales tax on building materials has at least doubled the clerical work.

MR. GRAY: We now have refunds of sales tax from the contacts which were under construction at the time of the budget. They are now subject to a rebate. That is a terrific job. Talking of regulations, there is the supplier of materials who includes sales taxes in his price, and there is not a thing in the law which makes him put on his invoice what tax is included in that price. Therefore, we do not know what to ask for rebate.

MR. MOLLER: Perhaps I should explain that my statement about the doubling of the staff has nothing to do with the refund, which will be temporary, because we have not filed one refund claim yet. That may be due to some inefficiency, or perhaps I should more properly say because of my doubt that the basis of the refund has really been determined by now.

MR. SOMERVILLE: I might just add to that, Mr. Coyne, that one of our general contractors with his head office in Montreal, who operates right across the country, estimates that in his business the additional sales tax imposed in June of last year will cost him an additional $50,000 to administer per annum. This is in a business doing $30 million to $40 million over-all construction and has sizeable contracts. The size of this is terrible when you think that the average profit in the construction industry in that area is

less than one per cent.

MR. COYNE: Thank you very much. I think there are many aspects of this which we will want to come back to when considering sales tax in more detail. Would you now turn to page 5, where you are setting forth certain principles of taxation. I am interested in No. 3, where you say:

> "All taxes should be certain and adequate advance notice be given before their introduction".

Then on page 12 you go into more detail on this aspect of it, and in paragraph 23 you say:

> "The procedure for the preparation of our budget in Canada ... has become impractical, inflexible and ripe for change. The secrecy of the preparation of the budget has prevented ... a thorough study of the planned fiscal measures.",

and so on.

Then on page 13, paragraph 25, you say:

> "Tradition has brought it about that tax measures announced in the budget become immediately effective. It is submitted that this tradition is again not in keeping with modern economic developments and should be abandoned."

Further on you suggest advance notice which would give the taxpayer sufficient time to rearrange his affairs in order to cope with the changed tax situation.

My question is whether you are putting these

thoughts forth in what you believe should be a general principle applicable to all taxes, or whether you really have in mind the difficulties, for example, which your industry is in as a result of a sudden imposition of the tax affecting previous commitments. I put this to you, if this is the general proposition that you are suggesting. If, for example, there is an excise tax on automobiles, obviously if the minister announces three months in advance that as of a certain date he will impose a ten per cent excise tax on automobiles, then everyone will try to buy their automobile before that date and there will be a great upsurge of demand to beat the tax.

By the same token, if he announces three months in advance that an existing ten per cent excise tax on automobiles is to be removed, everyone contemplating buying a car will defer doing so until the three months period is passed, in which event they will purchase the automobile tax free.

I put it to you that perhaps it is these sort of taxes which are of a more prevalent kind in the over-all picture than the sales tax in relation to building material affecting prior commitments. Would you indicate whether you are speaking in general terms, or whether you are only suggesting that advance notice be given in certain circumstances, and if so what circumstances?

MR. SOMERVILLE: I should just like to say before I ask Mr. Moller to answer that that the whole thing points out the fact that if a change is a large

one it will create the greatest confusion, no matter which way you do it. The confusion is very difficult to describe in the consumption industry at the moment, and the confusion which came about in June was absolutely fantastic.

As an example of a smaller tax of which notice was given and which caused no problems there was the imposition of the three per cent sales tax at the consumer level in the province of Ontario a few years ago. The construction industry was given four or five months notice of this tax and we worked together with the Department in the province of Ontario and had all the rules and problems worked out, so that when it came about it worked very smoothly. That was a three per cent tax. If it had been a ten or eleven per cent tax I can see that there would have been a surge of some activity somewhere.

So to me it comes back to the point that first of all you should not have these large staggering changes, and that when you are going to make a change it will have complicated rules in it. Be it large or small, advance notice is essential.

MR. COYNE: Then is it fair to say, Mr. Somerville, that you are not suggesting in the paragraph to which I referred that all tax changes be announced in advance, but that certain of them which would have these affects could be dealt with in the manner you have suggested?

MR. SOMERVILLE: I think that is right.

MR. MOLLER: I should like to put one thing

forward. I think that the secrecy of the budget was historically brought about --- I am not trying to put myself forward as an expert in the system of taxation, because there are people in the room who know much more about it than I, but it was mostly brought about by tariff changes, excise taxes, importation taxes or duties.

It is clear that any such change would affect the economic disposition of the taxpayer, the consumer or importer. I think that with the fast moving economy as we have it this consideration has lost most of its impact.

Mr. Coyne asked whether we suggested this as a general attitude and I would say yes, as far as imposition of tax is concerned, not the relief of taxation. We have a very good example now, gentlemen. There is an announced increase in taxation in Ontario. The guess is that sales tax will go up from three to five per cent. That may be a completely wrong guess, but let us for the moment assume that it is correct. We have issued a memorandum in our company to discover precise areas where it would make sense to accelerate our buying so as to escape this imposition of an additional two per cent tax. You will probably not be surprised to hear that anything to be bought which will not be used for two months, such as an automobile bought two months ahead, will be abortive of this tax escape. Anything which you buy three or four months ahead carries storage charges, inventory charges and loss of use, such as with an automobile, and this would

not make sense.

I admit that this is a two per cent impost which we are talking about, not an 11 per cent one, but may I respectfully submit that if the imposition of sales tax put on construction materials had been discussed with the industry beforehand, the introduction of this tax could have become an orderly procedure -- and again we should refer to Ontario -- whereas I think even the staunchest defender of the policy under which this tax was imposed will have to admit that three times changes had to be made in order to make it reasonable, which should be enough. The disadvantages of disclosing this intention before would have been much smaller than those caused through the sudden and not well prepared -- I do not think that is disputed -- imposition of the tax.

THE CHAIRMAN: You are talking of an eleven per cent rate, are you, Mr. Moller?

MR. MOLLER: I would say that even if it had been a four per cent rate that is the case. First of all, it would have been a four per cent rate. We know that the tax had to be reduced. Secondly, even a four per cent rate would have been better imposed after the industry had been able to help develop some rules and regulations beforehand, not after.

THE CHAIRMAN: While I might not find it too difficult to accept what you say with regard to a four per cent rate, I find it a great deal harder with regard to an eleven per cent rate. My question is, do you make this statement having regard to an eleven

per cent tax which was contemplated at the time of the budget?

MR. MOLLER: May I go back to Mr. Somerville's statement, which I think is profoundly correct, that no tax imposition should be made which is of such magnitude that it disrupts the normal flow of trade. Perhaps I have illustrated it with the two per cent tax now threatened in Ontario. This will not disrupt anything. In fact, it will make a very small impact on our buying decisions, or on the timing of them. Because if it goes beyond a certain point, savings are eaten up by interest, inventory charges and so on. Any tax like an eleven per cent tax which is imposed is not, in my opinion, reasonable.

THE CHAIRMAN: So there is no purpose in answering the question which I put to you?

MR. SOMERVILLE: It is difficult to answer that question because we concede that the advance notice of eleven per cent could cause the things which you suggest.

THE CHAIRMAN: You simply say that there should never be a jump of eleven per cent.

MR. SOMERVILLE: That is true.

MR. GRAY: Your own eleven per cent tax on the other goods other than construction was imposed in various stages.

THE CHAIRMAN: It is not my tax, thank you!

MR. SOMERVILLE: Mr. Stein has a point he would like to make in this connection which I think reinforces the position.

MR. STEIN: I am in no position to speak intelligently on the magnitude or exact percentage by which a sales tax imposition should be applied. I would, however, like to bring to your attention the fact that the construction industry is one of the few industries, if not the only industry, in which a commitment is made, a contractual obligation, to produce a building or any piece of construction work for a fixed price, notwithstanding any impending changes in labour costs, sales taxes, or sometimes in the purchase of materials. Some of these commitments last for a long time. Lump sum contracts are awarded which will last for two to three years, sometimes longer than that.

I would say that the average length of a construction project can be considered to be in the vicinity of one year.

COMMISSIONER WALLS: Do you not have a clause in your contract stating that this is your price, but subject to any changes in sales tax?

MR. STEIN: If you introduce that kind of a clause into your tender, your tender is not acceptable; it is completely disqualified.

COMMISSIONER WALLS: Is there not a tendency now in your industry to put that clause in the contract, so if you are all doing it they would not be able to disqualify them?

MR. STEIN: I think the lead is taken by the owners of the construction, who must know exactly how they can budget, and one of the clauses in the tender documents and specifications is "Not subject to change in price by any changes in labour rates, materials, tax, etc."

MR. SOMERVILLE: The Federal government is one exception now, with the new contract form that they have. The previous form set out that they wanted a rebate if it went down, but they would not allow anything if it went up.

COMMISSIONER WALLS: That is why I asked the question. It seems to me that the Federal government has created a precedent which your industry could very well follow.

MR. SOMERVILLE: We might be able

to do that, but we have not been able to sell it to anyone so far.

MR. MOLLER: May I point out, sir, that this is not quite a comparable situation, because the Federal government as such is the one which on the first hand imposes the tax, and on the other hand now agrees to give it back, or to rebate it. The owner does not impose any tax, and therefore he feels he should be in no position to pay more because the government imposes the tax.

MR. GRAY: Of course, the government put that in their legislation. In our brief we asked for an exemption of the tax, and instead of that we have to go through this elaborate rigmarole and --

THE CHAIRMAN: We will come to that later on. Let us not get into the sales tax, in particular, at this time.

MR. COYNE: Mr. Somerville, I wonder if we could turn the page to page 6.

I have one more question on this before we proceed to the sales tax section and come back to the other taxes later. Paragraph 14, sub-paragraph 2 states:

> " Fiscal policies should similarly be used to reduce the seasonal fluctuations in construction activity by such means as
>
> (a) accelerated write-off allowances

based on wintertime construction payrolls.

(b) the exemption from sales tax of items used to facilitate wintertime construction."

You refer to this subject again in some detail on page 27, but I think we can conveniently deal with it here. Let me put one or two propositions to you and then invite your comments.

I think one of the principles which you suggest, either expressly or implicitly, in this brief and which many, many others have also suggested, is the desirability of simplicity and certainty in the field of taxation to the extent that it is possible. But I put it to you that to devise a system of accelerated write-off allowances based on wintertime construction payrolls would probably be an exceedingly complex and difficult scheme to introduce, and as far as the exemption from sales tax on the items used to facilitate wintertime construction is concerned, the problem there of identifying the items which would be subject to the relief, as against items which were not subject to relief, would be even more complex.

Also, of course, any tax incentives of this kind introduce an element of discrimination, in the general sense, into the tax structure.

Why is it not more desirable to achieve the results which you are seeking through forms of direct subsidization instead of direct tax incentives as for corporations?

I suppose the winter works program in the public sector was a device which was intended to have this effect; the $500 allowance on winter-time construction is a similar one. Would you explain your views as to the relative advantages of these two approaches, the one through the tax structure and the other through direct subsidization.

MR. SOMERVILLE: I think I am going to let somebody else explain this, but one of the things I would like to say is that the basis of a wintertime subsidy, or help, whichever way you put it, over the years has proven to be very, very beneficial to the levelling out of the employment picture.

This is the reason that we want this; it is to help employment. We feel it has been so successful in the public field that we think it could be extended in some way to the private field, not so much to help the man who is building his plant to get a cheaper plant, but to get him to do it in the wintertime in order to help the employment picture. This is the principle behind it.

THE CHAIRMAN: Is there any general measure, or yardstick, or rough approximation of the additional cost of winter construction? What do you think that would amount to?

MR. SOMERVILLE: We did quite a detailed survey of construction jobs carried out in places like Montreal and Winnipeg and some of the northern cities in Ontario, and I think some 50 projects were reviewed, all in the area of \$750,000 to \$1½ million. We asked these people to tell us, not what the cost was, but what they put in their estimate, because this is all the owner pays, to take care of wintertime construction. The average increase was in the neighbourhood of one per cent. When we studied these projects in detail, we felt that the early occupancy far outweighed that one per cent additional cost.

THE CHAIRMAN: So, in fact, there is no difference, really?

MR. SOMERVILLE: Except in exceptional cases. On the average in building construction, I would say none.

THE CHAIRMAN: Why, then, do we have peaks?

MR. SOMERVILLE: Because people are still not convinced. We are working at it. The fact that they are getting closer to being convinced can be borne out by the fact that there are more construction workers employed during the winter months now than there were in the summer months ten years ago.

COMMISSIONER GRANT: Would that apply to the commencement of a contract in the winter months? Would you say the one per cent would be more applicable to the point where you had, for instance,

your concrete, your footings and your excavation completed; that is, when the concrete was poured and you were closed in? Does that make any difference?

MR. SOMERVILLE: No; I think the greatest benefit comes, from my point of view, when you start in the late fall or early winter, when you start the job. On the average it really does not matter a terrible lot, because you are into one winter or the next one, and on some jobs it would be less costly to put in the foundations in the winter and in others it would be more costly, with heating it and replastering, and so on.

MR. MOLLER: My company is going in the direction of rough deck floors and wall panels, which are all outside jobs, not sheltered. We have a clause in the contracts which are supposed to be scheduled not for the winter time. But if as a result the contract should extend into the period after November 15, through no fault of ours, and up to and including March 31 -- I am quoting from memory -- we add 15 per cent to the labour costs. This has been borne out through some studies over the years, that in cold weather, particularly freezing weather, but not in stormy weather, because in stormy weather we do not work -- if it is raining or snowing, the sheet metal worker or iron worker walks off the job.

MR. SOMERVILLE: You are spoiling my argument.

MR. MOLLER: I think we should tell

the story from our side. It would be 15 per cent on the labour cost, which is not a big contrast to what Mr. Somerville said about one per cent of the total cost.

THE CHAIRMAN: No. And the interior work is unchanged, of course.

MR. MOLLER: That is right, and the material is not costing more. So the 15 per cent may be similar to the one per cent that Mr. Somerville quoted. It does not make a very big difference. If you go into it, it may work out at exactly the same figure.

MR. SOMERVILLE: We have not answered Mr. Coyne's question. I will get Mr. Chutter to answer that.

MR. CHUTTER: Relating specifically to your question as to why we should do this rather than have subsidies, I think the feeling was that this was a brief to the Royal Commission on Taxation and, as there may be alternative methods of getting these things, this brief would concentrate on those in the taxation field.

With regard to direct subsidies as opposed to other forms of tax relief, I think there has been a reluctance on the part of the government in the past, and on the part of the industry itself, to suggest such action. This was a very unusual action that was taken, and it may be of relatively short duration.

With regard to the point that it would mean complications in the tax structure, this cer-

tainly would involve some on the part of the buyer of the building; but it is felt that it would be no more difficult than the present procedures which are followed with regard to municipal contracts and others, which now constitutes a large program. The proposed procedure is identical. That is, it is based on wintertime payrolls and we suggest that it would be only an application of that.

The cost of construction may average out at a relatively nominal amount, but there are variations to that theme, of course, of considerable size. Apart from that, there is this tradition of prejudice against wintertime construction, that it is inferior or exceedingly costly. The industry is not at all impressed with that in most cases, but the owners are the people who pay the bills and they have to be convinced.

The municipalities are doing an amazing amount of work which they never did in the winter before, because they have an incentive to do it. Inasmuch as private works constitute about twice as much as public works, we feel this should be applied to private works and construction because presumably they might jump to the incentive with even more alacrity than the municipalities.

With regard to the question of the men involved in operating these programs, it may be of interest to the Commission to know that there are more people in the Department of Labour concerned with the administration of the $500 bonus

than there are in the other sections of the department administering the winter works incentive program, by far. But that is by the way.

With regard to (b), the exemption of items from sales tax, I must say that this is a recommendation which dates back pre-1963 budget, when at that time it was one of the general ironies that whereas the majority of construction materials were exempt from sales tax, those substantially used to facilitate wintertime construction, such as heaters, tarpaulin, polyethylene sheeting, and so on -- they are only three or four in number -- would be all taxable. This is mainly a psychological suggestion, if you will, to exempt them. But it seemed rather ironical that this should be the position, in as much as the government was strongly in favour of the idea of wintertime construction.

As to the objective here, to provide employment, and the fact that there are more people employed in the winter time in the industry now than used to be the case in the middle of the summer, the number of unemployed people designated as construction workers is also higher and there is a matter of a 30 per cent or more spread between the peak and the depth in construction employment. So the problem is still there and it is a real one.

MR. COYNE: I suppose, accepting what you say as to their being no real difference in cost, the problem, would it be fair to say, is really an

educational problem rather than a fiscal one? It may be doubtful as to whether the government would be justified, in those circumstances, in reducing its tax revenues to overcome this educational problem, which is essentially one for the industry.

I have in mind the prejudice against winter work, which seems to be irrational, from what you say.

MR. SOMERVILLE: On the other hand, sir, the government would save a certain amount of funds in the unemployment insurance area, so they really would not be robbing themselves of anything. They would be paying it out of one pocket and would keep something in another pocket. From that point of view I think it is justifiable; and we have found that with the help of the municipalities, by being subsidized, education in this regard has been greatly enhanced.

THE CHAIRMAN: I do not think the government would save money in regard to unemployment insurance. It would save money in the winter and would pay it out in the summer, that is all, assuming, as you seem to suggest, that summer construction would be down.

MR. SOMERVILLE: There are a great many people who do not work in the construction industry in the summer that all of a sudden appear in construction in the winter.

MR. CHUTTER: Although a lot of jobs are one year or more, there are a vast number of

construction projects which are of shorter duration -- perhaps not carried out by the gentlemen seated to my left -- and which are of four, five or six months duration, which in the aggregate add up to a great deal of construction employment. They are the ones that may well appeal to the owners if they have an incentive to go to the winter instead of the summer. The big jobs involve working in the winter anyway.

MR. COYNE: It might be convenient now, Mr. Chairman, to turn to the sales tax section of the brief which commences at page 42.

THE CHAIRMAN: For our convenience, Mr. Somerville, we thought we would take sales tax first, if it makes no difference to you people.

MR. SOMERVILLE: No, sir; that is fine.

MR. COYNE: You commence with some general statements under the general heading of "Sales Taxes" in paragraph 111. You say,

> " As pointed out earlier in the brief, the CCA is opposed to the application of any sales tax on construction materials and equipment on the grounds that it constitutes a tax on capital."

Then you say:

> "The Association is similarly opposed to the imposition of sales tax on production machinery and equipment."

Reverting to the question of a sales tax, if you like, on consumption or on consumption goods, why in your view should any distinction be made between consumer capital goods to the extent of imposing tax on most, if not all of them, such as automobiles, washing machines, furniture and the like, and not imposing some sort of sales tax burden on houses, which at least in one sense fall into the same category as other capital goods purchased by consumers?

MR. SOMERVILLE: I am going to ask Mr. Stein to talk to this in detail; but generally speaking I think we just make our point again in this respect. You put houses in the same category as other manufactured goods for sale. We think that the things that might be taxed, as opposed to the things that go into the capital structure, are in themselves small things. The base is spread over many, many people, whereas the building that is built creates employment for more people and makes it possible for us to be competitive in world markets.

MR. COYNE: This is why I would like to get back to the distinction again. Certainly I can see the proposition that a factor of production goods is in exactly the same category as machinery and equipment. It is production apparatus designed for the production of goods, and an argument can be made that production machinery, equipment and apparatus -- in fact, all production costs --

should be exempt from tax. But surely a house is in a different category. A house is not something which is used to produce goods; it is something used by consumers to provide themselves with shelter, in the same way that an automobile is used by consumers to provide themselves with transport. And one could go on, of course.

It would be interesting to know what distinction you draw between houses -- which, of course, is the aspect with which you are concerned -- and other goods purchased by consumers with which other industries are concerned.

MR. SOMERVILLE: Basically, I think it is the size of the expenditure.

THE CHAIRMAN: I would like to ask a question on this, Mr. Somerville. You tried to switch it away from consumer to production, which spoiled your answer as far as I am concerned, because that is too easy. But I look at the analogy of houses and clothes. They are both coverings. We tax our clothes and we do not tax our houses. That is what you suggest anyway.

I would have thought that if the test is essentiality we would have reversed that, that clothes would be exempt before houses would be exempt.

So far as employment goes it takes people to make clothes and it takes people to make houses. When we come down to houses, I am in the same position as Mr. Coyne.

MR. STEIN: I am not an economist and I am not a tax expert and I can only speak from the point of view of someone engaged in actual construction, and I would say that to every rule there must be an exception that proves the rule, and perhaps you must consider housing as one of these exceptions.

One thought that occurs to me is that substantially the same materials are used in housing as are used in constructing a factory building, and if we are trying to simplify the tax structure whereby materials used for one purpose are taxable and the same material used for another purpose are non-taxable, I think we are only going to complicate the issue.

MR. COYNE: Well, of course, this is an issue, Mr. Stein, which many of the manufacturers' have faced through the burden of their manufacturers sales tax; but just to pick up your point in paragraph 113 on that same page, you specifically recommend a simplified method of collecting such taxes:

> "...whereby a single tax is levied on the value of the completed work at the rate which was approximate to the Federal and/or Provincial

sales taxes on the construction
materials used in the project."

What would be your objection, in effect -- and this may be over-simplified -- to making a contractor, in effect, for tax purposes a manufacturer. He would then purchase all his materials tax free under his manufacturer's licence and there would be a tax imposed on the finished product.

Conceivably, one might argue that in the case of a factory and goods which are of a production nature, that the manufacturer, as the one who built the factory, should be entitled, if production machinery is exempt, to purchase the factory even under licence in the same way as prior to June 13 he was able to purchase production materials free of tax?

Has the Association given any thought to this type of arrangement, or would you care to comment on it?

MR. STEIN: We have given a great deal of thought to it, and basically the concept of this method is good and sound, because it would certainly reduce the administrative costs of tax collecting, tax payments, tax refunds and tax accounting, and I think it could work.

There is, however, always the danger -- this is, perhaps, a personal opinion and other members of the Association may not agree with me -- that you are opening the door to discriminatory taxation when this element of labour becomes involved.

MR. COYNE: Well, I suppose in the case of other goods which are taxable the labour content of those goods is indeed taxed, because the tax is imposed on the selling price. Mind you, there is always the question of rates, and your suggestion here, I take it, in effect, is that the reduced rate be applied as a single tax, roughly to be equivalent to the appropriate rate on the material content only.

MR. STEIN: Right.

MR. COYNE: But would that not be possible under the other scheme? You might argue that the rate should be 6 per cent instead of 11 per cent on houses.

MR. CHUTTER: With reference to houses, this would seem to me to be the main purpose, because they run about 30 per cent of construction; but you compared a shelter with clothing, and I think the third fundamental for a product which is exempted -- I wonder if I could introduce the term "social capital" -- I am not arguing whether it is right or wrong -- but usually there is a distinction made for certain types of projects which call for social capital and are exempted -- schools, universities, libraries, hospitals; and generally speaking housing is included under most breakdowns as an item of social capital.

The background to postwar sales tax exemption, of course, was that they reinstituted the term because of the administrative difficulty, and the rest of the industry, you might say, benefited

from this conditional exemption. In our industry we have various projects using identical material, but the exemption was given to housing because it was desirable for social reasons.

I would also wonder if you would make a distinction between housing and apartment buildings, because actually apartment buildings are rental accommodation and are now becoming an increasingly important factor in the housing market. Predictions are that they will exceed the half way mark before long. An apartment building is, in fact, a capital outlay for investment. It is subject to depreciation, and its taxation treatment is different. Does an apartment project which gives shelter differ from a house which gives shelter?

MR. COYNE: It perhaps raises a problem.

I take it that essentially what you are suggesting is exemption for housing on the ground of essentiality on the same basis as the exemption for food; but in that event would it be possible to give effect to some form of essentiality of this nature by saying that all houses under a certain value should be tax exempt, but if above that value, such as a $100,000 mansion, should probably bear tax?

THE CHAIRMAN: I wonder if I could cut in, unless there is an answer coming. There is an answer coming.

MR. CHUTTER: I think the Department of National Revenue should perhaps answer that one. From the administrative standpoint the number of houses which will run into the mansion class is so small that the revenue involved and the administering --

THE CHAIRMAN: The answer would be in the affirmative, subject to administrative difficulties which rule it out.

MR. COYNE: And I take it, also, that there is the question as to whether any worth-while revenue would be likely to be earned on the higher priced house.

THE CHAIRMAN: They do not argue with the principle.

COMMISSIONER WALLS: To get away from the matter of the assumptions which can be drawn from your recommendations in paragraph 113, it seems to me that there is some merit, of course, in your suggestion in paragraph 113 because it places those in manufacturing in the same situation under the present type of tax. as is the case of the end-use manufacturers, where all the way down the line the components are exempt from tax, then the tax is put on the finally manufactured product; but so far as saving in administration, as has been mentioned, if the tax is continued as a manufacturers' tax, the administration would be almost as great as it is today, because you will have to license building suppliers,

subcontractors, and your final contractors. Of course, they obtain the exemptions all the way up the line from the initial manufacturer. That is under the tax as it is today. Though I would question that you would escape too much from the administration, which is what you seem to emphasize in that paragraph.

MR. MOLLER: May I respectfully submit that the administration of the manufacturers' sales tax at the manufacturer's level is difficult but, in my opinion, it is incomparable with the difficulty that the contractor runs into now, because he is a collector, if you want to put it that way, of almost sometimes an indistinguishable maze and mass of components going into his work, which the manufacturer is free of worrying about because he pays them under his manufacturer's licence, and then the tax is imposed -- and I do not want to go into the details of manufacturers' sales tax, but it is imposed at one specific point as one tax to be paid. Particularly, the manufacturer/contractor is, I think, the most unhappy of all creatures through this imposition, because he is really committed as half a manufacturer and half a contractor, and it becomes almost impossible to distinguish between the two functions. If he could buy everything on the manufacturer's licence and then be subject to a lump sum tax -- meaning not the 11 per cent, of course, but an appropriate lump sum arrangement --

he could administer the tax not as simply, perhaps, as the manufacturer, but certainly in a much less complicated way than the contractor does at the moment.

COMMISSIONER WALLS: Perhaps you may be correct.

MR. SANDFORD: The idea behind this is not that the contractor should become a manufacturer and operate on a manufacturer's licence; the idea is that the tax would be on the completed structure; whereas -- and this is assuming that our first suggestion is going to be acted on -- the completed structure would be taxable at an appropriate amount of tax; and the taxpayer would be the owner, the collector would be the government, and the contractor would not be involved. The tax would then be levied on the owner unless the owner should happen to be --

COMMISSIONER WALLS: But how would the manufacturer, let us say, of house hardware, locks and handles, and so on, know whether that item was going out to a building contractor to go into a finished house, or going for any one of the myriad uses that they may be bought for? He would have to have some type of exemption form, and as soon as it went out to other people it would have to be registered and have another exemption form.

MR. SANDFORD: I would suggest that as building hardware is not a large percentage of the industry, to be put in a completed structure of

some kind, there may be a few missed; but if they are used they are covered by a building permit; and if you did not worry about the odd use of a door knob, the amount of revenue involved would be very small. And most of it would be collected off a completed project; and the amount of loss of revenue would not be great. The tax would be at the time the building ---

COMMISSIONER WALLS: Let us leave hardware. Take cement which has a multitude of uses. They would have to have some means of identifying where that cement was going.

MR. SANDFORD: It would be the responsibility of the owner in the case of cement going into a building on an engineering project; and in most engineering projects the owners have the exemption; and so also with the tax on roads and highways.

THE CHAIRMAN: On the same question: Are you proposing that all building materials be exempt from tax?

MR. SANDFORD: No. The suggestion in paragraph 113 is that the method of collection be changed. Our first suggestion, of course, is to be exempt, but if this is not acted upon, then they should be collected as a percentage of the completed building project.

THE CHAIRMAN: I recognize that; but how would you carry this out? Would this not mean that all building materials would be exempt?

MR. SANDFORD: At the time of purchase from the builder.

THE CHAIRMAN: From the manufacturer?

MR. SANDFORD: Yes; and the tax would come on at a later stage.

THE CHAIRMAN: There is an awful lot of building material that does not go into buildings -- wire, plumbing, cement.

MR. SANDFORD: Most of them end up in buildings.

THE CHAIRMAN: You say "most" but I would like to put it perhaps on a 50-50 basis.

MR. MOLLER: I submit that exemption certificates would have to be given by the construction industry, and I cannot see too much of a difficulty in that because it is going on all the time. It would be a construction industry licence instead of a manufacturer's licence, and it would have to bear a few different features than the manufacturer's licence because of the variety. But I cannot see how we could get away from an exemption process altogether.

THE CHAIRMAN: Or a licensing procedure?

MR. MOLLER: Yes. The point is that there would be a terrific saving in administrative procedures because of the unnecessity -- the relinquishing of figuring of this tax through all these stages.

THE CHAIRMAN: It would bring down the labour in the tax but in compensation for that it would bring the rate down.

MR. COYNE: It would also simplify estimating problems.

MR. MOLLER: Yes, terrifically. The big thing is that today everybody is taking the risk in estimating sales tax on components at 11 per cent.

MR. COYNE: There is one question that I might ask arising out of what Mr. Sandford said, and that is that you suggest that the contractor should have no responsibility for the tax at all; it should be imposed on and collected from the purchaser.

I take it from that that what you are really suggesting is that this should be a new type of tax altogether so far as construction activity is concerned; and I put it to you that one of the virtues of the manufacturer's sales tax is the relatively small number of persons whom the government can look to for collection of the tax, all of whom are licensed in one way or other. Is it realistic to suggest that all the hundreds of thousands of people who purchase houses or other constructions should be assessed and the tax levied directly against them?

MR. SANDFORD: I think the Commission is aware of discrimination in the manufacturer's sales tax paid, through methods of marketing. This has occurred in different types of manufactures. There is discrimination introduced there, and if this discrimination is extended to the construction

field -- Mr. Moller mentioned about on-site fabricating and prefabricating. The trend today is towards prefabricating, and the tax discriminates against the prefabricator.

We felt that it should be spread over; there would be a lower rate and there would be less inclination towards avoidance, and it would be spread over and more equally divided.

MR. COYNE: I think the thought of discrimination you speak of, to the extent that it exists, would be taken care of by your general proposal where you state that the overall rate of tax should apply to the total price of the contract.

My question was more related to the problem of collection. Applying your suggestion logically to the existing structure, I put it to you that the method of collecting would be through the contractor who, as Mr. Moller suggested, would probably be licensed in some way or other if the scheme were to benefit, say, the manufacturer of automobiles.

Otherwise, would there not be very great difficulties in the government pursuing the individual citizens who bought houses, so as to collect tax from them?

MR. MOLLER: I may say in reply to this point that the licensing of contractors for tax purposes would also have another beneficial effect, because it would eliminate this fly by night and moonlighting construction, because you would have to have a licence to do construction work and you would get it only like a manufacturer gets a licence if he can prove he is worth a licence.

MR. COYNE: If one did not have a licence, I suppose that one could still purchase materials.

MR. MOLLER: Yes, but he does not get the exemption.

MR. CHUTTER: They would also be subject to tax audit. In other words, the cost of a new structure would be part of their own financial records which are audited regularly. If the capital cost of a new structure is to be the basis for the application of a sales tax, it is also subject to audit.

MR. COYNE: I put it to you that there would be no difficulty in collecting the tax from the Ford Motor Company if they built a new factory, but there might be some difficulty in collecting the tax from you or I if we built ourselves a new house.

THE CHAIRMAN: That is the same problem which we have now with people who do their own building.

MR. SOMERVILLE: One other point which is

related, but not entirely related, to the mechanics of what we are talking about, and that is that if the tax is imposed at the end as we are suggesting, we are quite sure that the ultimate cost of the product when it is built will be less, because the tax collected at the manufacturing level tends to be pyramided on the way up. I think the government should get its revenue at less cost to the consumer.

COMMISSIONER GRANT: I should like, Mr. Coyne, you to explore the method of determining the amount of materials subject to tax in the completed structure, and what method the witnesses would advocate in the event that the tax was to be collected in that manner. I think we should explore that further having regard to the fact that house building, I think it was said here this morning, is about one-third of the total expenditures on construction in a given year. A great deal of that house building is taking place not under contract. With that as a premise, how would you determine in a fair and equitable manner the amount of building material which is going into that house which would be subject to tax?

MR. COYNE: Thank you, Mr. Grant. Could you expand on the procedures that you had in mind when you formulated this suggestion? I suppose one question, for example, would be whether you would simply have a rough and ready percentage which applied to all structures, or whether you would break it down by different forms of construction, to which different

formulae would apply?

MR. SOMERVILLE: Mr. Stein is familiar with a number of conversations with the Department of National Revenue on this subject, and I think he could expand on that.

MR. STEIN: Well, we have had more than conversation. We have actually had work sessions in which we took estimates from about half a dozen contractors, and a general contractor's estimate is in great detail. It separates labour, materials, overhead charges, sub-contractors and so on. We as general contractors took our own estimates apart and established the material content of the project. We went through each and every subcontractor, and with the assistance of the subcontractors we established a ratio of labour to material and were able to separate out material content. Then we worked out the percentage of contract or percentage of materials in a contract.

MR. COYNE: Would you propose that this detailed calculation would be done for each individual contractor?

MR. STEIN: No, sir, you could not do s There is a tremendous variation. I think we should consider two phases. First of all, throughout the period prior to the June 13, budget, certain construction materials were subject to an eleven per cent federal tax and the bulk were exempt. We had a personal experience of this. We were once asked to estimate the value of the federal tax as it applied

to a high school. This is prior to the budget. We went through the same procedure and ended up with an estimate. We went through this again working with the Department of National Revenue, seeking to find a simplified procedure for refunds. This is an estimate, it is admitted, but it also must be realized that the amount of federal sales tax ends up ultimately as an estimate.

MR. COYNE: If you would not go through this procedure for each individual project -- and I can see the reasons you put forward for that -- you would simply have a single factor for the whole of the construction industry, or would you divide construction into four categories such as housing, factories, schools et cetera?

MR. STEIN: I think it would have to be categorized because of the variation. If you go to schools, we have the whole gamut from the elementary school which is never more than two storeys high to the university which can be multi-storeyed. Your types of materials are so vastly different in the whole gamut of schools from one extreme range to the other. Similarly in housing, I think you have to categorize, because you have an individual house, a row of houses, or a duplex or even a triplex, if you like, compared with the multi-storeyed apartment buildings.

THE CHAIRMAN: It depends on whether you change the system or simplify the existing system which levies a tax on materials. If you change the

system and tax the building as though it were a product, you would have one tax on all buildings irrespective of the labour content or the material content.

COMMISSIONER GRANT: In determining the cost of the building you have to start from thatand work backwards. Let us assume that you would adopt that procedure to determine the material content. How are you going to determine the cost of that? Are you going to determine it on a square foot basis or on a cubic foot basis, or what is your unit for determining the cost?

THE CHAIRMAN: The cost record would be available for that.

COMMISSIONER GRANT: Thatis all right with one contractor who has built several houses, but how are you going to do it for the whole industry?

MR. STEIN: I think the formula could be established on the basis of a sampling, by going through this procedure on several typical projects and arriving at an average.

COMMISSIONER GRANT: We are dealing with house construction now. Let us say that a firm which is in the contracting business gets a tender on a house which might conceivably be a good deal higher than that of a firm which is specializing, instead of a contract with a firm in the nature of the companies you are representing here. You are not in the house building business but you do occasionally some house building, let us assume. Your price on a

specification for a house might conceivably be, for the sake of argument, higher than that of the man engaged in straight house building. Therefore, whose price are you going to take there?

MR. STEIN: The essence is this, that the material content is not affected. There are so many square yards of plaster, so many bricks, so many thousand feet per measure of lumber, and so many cubic yards of concrete in a house. No matter who puts it in the material content is not changed. If there is a variation in price between various contractors, it is boiled down to labour, overhead and profit -- he hopes.

THE CHAIRMAN: In order to simplify the procedure -- I think I understand what you say -- you categorize it and the only thing you need to determine when categorizing is the portion of your labour and material cost. Once you know that you have your formula and that ends it.

COMMISSIONER GRANT: If you can get a standard to it.

THE CHAIRMAN: No, all you need is to approximate it.

MR. STEIN: If it is approximate everyone, including the purchaser, knows that it is "x" per cent.

THE CHAIRMAN: The house would be so much per cent labour, so much per cent materials, and if you could agree with the department on that all houses would be taxed on that basis. Factories would be a different proportion, institutions a different

proportion, and commercial would be different too.

COMMISSIONER GRANT: If you ever put such a formula on the statute books of the country, I can assure you that you would have a tremendous number of small builders and the man who builds his own house taking violent exception to the standard set down.

MR. CHUTTER: It was the House Builders Association, representing the Association, which recommended this procedure.

COMMISSIONER GRANT: A lot of houses are built today which have no connection with the Association.

MR. MOLLER: These people will not be exempt from sales tax. They cannot buy unless they have a licence, so it is no problem whatsoever. If I may say so, Mr. Grant has posed a problem as to different contractors calculating different prices for the same type of building, which is the same problem which we have with the sales tax, where one manufacturer charges more for a shoe than does another, and you pay eleven per cent on what he charges. We -- when I say we I mean the taxpayers -- do not care whether he makes more or less profit. He has to charge eleven per cent. If he is lucky enough to get a better price for his product than another, he can do so, but the eleven per cent is based on his price.

It is the same here. If he gets three per cent on a house, if he builds an expensive house it will be three per cent on the price of that more

expensive house.

COMMISSIONER GRANT: Your example would be an appropriate one in comparing shoes with houses if we had a great many shoemakers still in existence in this country who were building their own shoes, but we have a lot of people in the country building their own houses.

MR. MOLLER: They would not be touched by the tax. They would pay tax on the material.

COMMISSIONER GRANT: Where? When they bought it?

MR. MOLLER: Yes, as they bought it.

COMMISSIONER GRANT: Then you would have to have two systems in operation.

MR. MOLLER: No. He has no licence and has to pay the tax. It is just as if you built your own radio instead of buying it. You have to pay tax on the parts.

COMMISSIONER GRANT: The contractor would be taxed on his sale and profit.

MR. MOLLER: Only the licensed contractor would be taxed.

COMMISSIONER PERRY: May I just clear this confusion in my mind as to the implication of what has been referred to as categorizing. As I read your brief, you come out with one rate, and the object of the exercise in determining a labour content is to determine how much lower than eleven per cent this rate will be. Where does categorizing come int that sort of contract? You could go on to say that

you do not have to have just one rate but a series of rates for residences, factories and so on. But I do not think your brief says that. It speaks of a single rate.

MR. SOMERVILLE: I think that we should have said it. We meant that. We meant a single rate for a certain category, and the establishment of categories, we submit, if they are reasonable, would be a lot simpler than the present business of trying to get refunds.

COMMISSIONER PERRY: You might end up with three or four sales tax rates applying to construction which is payable by the contractor.

MR. SOMERVILLE: Yes, instead of a great deal of confusion.

COMMISSIONER PERRY: Which I think is really a refinement of what you have here, perhaps a worthwhile one.

THE CHAIRMAN: If it was impracticable to vary the rate, you could achieve the same result perfectly happily by applying the rate to the material content according to approximation which can be established, instead of changing the rate.

COMMISSIONER PERRY: The same rate but a varying base.

THE CHAIRMAN: Yes, that is right.

MR. MOLLER: In effect that is what we are suggesting. The whole thing came up, and perhaps Mr. Stein can explain it better than anyone else, from the refund point of view. We had to find out

how to simplify the refund. If he can simplify the refund by determining the percentage of the material content, why not use it in the future for taxation purposes?

COMMISSIONER PERRY: I think the principle is quite clear. It is a question of how precise you want to be in applying it. You could establish a crude average content for labour for all materials.

MR. MOLLER: Again there is the precedent of the manufacturing sales tax. The contracting industry pays about 55 per cent of the price. This is not without precedent; this has been going on since the sales tax existed.

THE CHAIRMAN: We find sales tax applied in many industries with that result.

MR. CHUTTER: It is the element of the single tax collection which appeals and our members have noticed that when they have completed a structure the architect or engineer engaged to design the project, and perhaps supervise its construction, his fee is based on a percentage amount of the contract or the value of the work. There is one calculation which can be made. If the architect's fee is five per cent, it is five per cent of the capital cost. There is a contrast between that and the multitude of tax applications and calculations on literally scores of thousands of items going into any major project, which would be extreme. There could be one collection andthe contractor could be treated in exactly the same way as an architect's fee is now

collected.

MR. STEIN: I just would like to elaborate on Mr. Chutter's example of an architect's fee. We have a case of a tax which worked in that way exactly with a great many municipalities who imposed a building permit tax. The cost of your building permit is based on the contract value. In Montreal, let us say, it is $2 for the first $1,000, and $1 for every $1,000 after that until $100,000, and then it is 50 cents per $1,000 of contract. This is one calculation which is based on the value of the building and the contract price. That is a very simple procedure. Other municipalities insist that you have that plus so much per square yard for plaster and so much per cubic yard of concrete, and so much per thousand bricks and so much for concrete blocks. They have a long list which is supposed to pay for the water consumed. It is much simpler when it is all lumped together at $1 per thousand or 50 cents or whatever it is, and then you are done.

MR. COYNE: I wonder if we could pass on to some of the more detailed matters. On the next page, page 43, you are dealing with the problem of determining notional wholesale values for purposes of assessing sales tax. It is not statutorily provided for at the moment, but it is provided for in some instances by so-called ministerial regulations. This is a problem which has been put to the Commission many times, principally by makers of goods who are concerned with discrimination which sometimes flows

as a result of competitors having different methods of distribution, and therefore finding the incidence of the tax different.

As far as general contractors are concerned, I take it you are more purchasers of goods than makers of goods. Could you say whether or not this is a significant problem for the construction industry, that is, the determination of the sales tax of goods for tax purposes?

MR. CHUTTER: We have calculated on the average sizeable building that the proportion of it for which many building contractors are responsible runs at about 40 per cent. So you can see that it is a sizeable problem in our industry.

MR. COYNE: Within the realm of manufacturing contractors it is in fact a problem. In other words, is it a fact that different manufacturing contractors competing with one another in fact have different systems of distribution?

MR. MOLLER: May I put it this way. The manufacturing contractor having been essentially not subject to a tax has developed various ways of splitting their activities between its subsidiaries, which do only the erections. Others have left it together, they do not distinguish.

Therefore there is immediately the seed for inequality between people doing exactly the same thing only in a different way. They do not go through a separate construction company, and others do. It makes a difference, of course, on the way in which the tax is now imposed.

MR. COYNE: You refer to the problem here. Are you making any specific recommendations as to how the determination of sale price in the statute might be imposed?

MR. MOLLER: We are talking about our recommendation with regard to installing an appeal procedure.

MR. COYNE: The appeal procedure follows in the sense that your recommendation, I think, is two-pronged, so to speak: There should be some statutory provision for determining the selling price, and if the Minister applies that and the taxpayer is dissatisfied, he should have a right to appeal the Minister's determination to some tribunal?

THE CHAIRMAN: Mr. Coyne, they have accepted the statement of the Sales Tax Committee, which I may say I am very glad to see. Perhaps they can by implication accept, or reasonably accept, the definition that is set out there as to what a sale price is.

MR. MOLLER: Exactly.

THE CHAIRMAN: That is what you mean?

MR. MOLLER: Yes, the recommendation of your previous Commission.

THE CHAIRMAN: Yes. We set forth a definition of sale price in it, which might be improved upon, I think; but it probably gets to the basics of the question.

MR. MOLLER: That was exactly what was in our mind. In fact, we have said it somewhere.

COMMISSIONER WALLS: It seems to me that the matter dealt with in paragraphs 118 and 122 are much the same thing. You are dealing with the problem of prefabricated units. When the 1962 and 1963 amendments were put into effect, that was at the request of a great many branches of your industry, as I understand it, in that no matter whether the product is now made on-site or prefabricated, the prefabricated manufacturer is no longer listed as the manufacturer and he pays his tax on the materials. That is the way it is now, is it not?

MR. MOLLER: If I may suggest, sir, only in a rather restricted fashion. The products to which that applies are limited to a number of products, but not exactly. There is a great deal of confusion on what, for instance, is a structural steel component and what is not. To the best of my knowledge -- but nobody can tell us for sure -- it does not apply to curtain wall construction, which can be fabricated in or out.

COMMISSIONER WALLS: Or kitchen cabinets, or hot air ducts. But generally speaking it has put it back on an equitable basis, has it not?

MR. MOLLER: May I very respectfully

submit, sir, that perhaps it is the other way around.

COMMISSIONER WALLS: That is because you are a prefabricator, perhaps.

MR. MOLLER: The exemption is limited to an enumerated number of items and quite a number of items are not even mentioned, or certainly do not fall under the exemption.

THE CHAIRMAN: My understanding is that you do not think that what has been done achieves equity?

MR. MOLLER: I would say that it is a step in the right direction, but it stops far from being complete.

COMMISSIONER WALLS: It does not apply to enough of the prefabricated items?

MR. MOLLER: That is correct.

COMMISSIONER WALLS: There are a number of exceptions. This does not apply to any prefabricated things that go into buildings?

MR. MOLLER: And our company, and a company which manufactures such items which fall under steel components, find themselves in an absolutely impossible situation, which has been further complicated by yesterday's memorandum from the Department of National Revenue.

MR. SANDFORD: The intent of this legislation was to take care of the situation, but the interpretation placed upon it by the Department of National Revenue, that structural building sections be load-bearing, completely eliminates most walls. I

think we would all agree that walls are an essential part of a building, but because they are not load-bearing in the opinion of the Department of National Revenue, they are completely left out as being subject to the relieving provisions of this section.

MR. MOLLER: Perhaps I may put it this way. The intent of the legislature is not being followed by the administration. That is, of course, not an exception in industry and it might often be the case in other parts of the tax administration also.

MR. COYNE: Mr. Moller, is there any actual discrimination, in the sense that certain types of products fall within these relieving provisions and certain other types of products which complete with them are taxable?

MR. MOLLER: A simple explanation is this. If it is a brick wall, for instance, or a cement block or brick wall, as against what is called curtain wall construction, where the wall components are hung, they are therefore not load-bearing. I would say that is a correct interpretation of the statute as it now stands, and it is excluded by the Department of National Revenue. The intent, of course, is not followed, as I say; but I would not have any quarrel with the Department on their interpretation as the legislation now stands, because I think their interpretation is correct.

MR. COYNE: Is there any objection, as

far as you know, to reversing the field, as you suggest, and going completely from this selective process that is enacted in the present legislation to the type of broad provision that you recommend in paragraph 122, which is simply that all pre-fabricated building materials be assessed in this way?

MR. MOLLER: On the material component, and so on.

COMMISSIONER WALLS: There is only one other thing in this respect. You create another anomaly in the Act by doing that, because the finished product is actually the end-use, and other manufacturers have to pay tax on the end-use. If you created another breakaway from that, it would create another anomaly in the Act.

MR. MOLLER: But may I again submit, sir, that this precedent has already been created in the discount system, which is very far-flung, prevailing right now, long before anybody thought of applying it to construction material.

COMMISSIONER WALLS: I agree that there perhaps was not much else the government could do, because of the complaints of the people who were building these same things on the site. Take, for instance, concrete forms; if they were pre-fabricated, they were taxed one way; if they were constructed on the site, they were taxed in another way. So that criticism as to the anomaly was justified.

MR. COYNE: On the other hand, all these problems would disappear if your recommendation for a single tax, which we spoke of, was instituted?

MR. MOLLER: That is right.

MR. CHUTTER: Apart from the competition between off-site and on-site, you do have some major materials. Take concrete; the aggregate content in concrete is not taxable because it comes out of mines and quarries, et cetera.

THE CHAIRMAN: I am sorry; I did not hear the last sentence.

MR. CHUTTER: The aggregate in concrete -- that is, the sand and gravel -- comes out of mines and quarries and is exempt from Federal sales tax. The tax is only applied to the cement or any additives. It is the same thing with laminated timber. So people supplying other building materials will claim that the concrete people have a big jump on them because the sales tax only applies to half of their material. You have not only this on-site and off-site argument, but also the different applications to different materials.

COMMISSIONER WALLS: You are not suggesting that we now tax sand and gravel?

MR. MOLLER: No, indeed. We suggest that a lump sum payment on the value of the contract would eliminate all these problems.

COMMISSIONER PERRY: Did you not admit earlier that there will be situations where an individual purchaser will be buying these materials?

MR. MOLLER: That should be the exception.

COMMISSIONER PERRY: I am thinking of these sort of things being purchased for repairs, where the plant might have their own staff for this purpose and might buy a new panel.

MR. MOLLER: And then they pay tax on the value of the panel.

THE CHAIRMAN: Yes, but because it is only the builders who are going to secure exemption, the individual would be taxed?

MR. MOLLER: Yes, if you buy it on that basis. In this case I do not think it would be an extreme hardship if they paid the full sales tax on the value. It is a manufactured product that they buy and that is all there is to it.

MR. CHUTTER: And the manufacturers would get more business.

COMMISSIONER PERRY: Would you abolish the principle which has now been instituted in the law for replacement materials, for finished products?

MR. MOLLER: It is not a construction contract. You are on the same basis as if you buy something which is normally exempt as part of a building in order to repair a building. You cannot have an exemption unless you are a manufacturer, in which case, of course, you would not pay on your wall panel, because you could buy it -- not any more; I am sorry.

MR. COYNE: But is there not a

discrimination here between a person who is licensed and a person who is not licensed?

If the person was simply a home owner and was not licensed, he would pay tax. But if he were a manufacturer, he would have a manufacturer's licence and --

MR. MOLLER: Of course, now if he were buying any building material or any material which is not going directly into his product, he would have to pay the 11 per cent. The manufacturers are claiming that anything going into construction should not be subject to the pyramiding tax.

MR. COYNE: Mr. Chairman, I was now proposing to move over quite a few pages.

THE CHAIRMAN: Just a minute; I do not think Mr. Perry is satisfied.

COMMISSIONER PERRY: I do not think we are talking about the basic problem, which is on-property assembled versus off-property assembled. Your manufacturer still would be in the position of having a choice of either buying a completed component or the materials with which to assemble the thing on the site himself.

MR. MOLLER: But the magnitude --

COMMISSIONER PERRY: On which basis will he pay tax?

MR. MOLLER: If he buys a prefabricated panel, if he does not employ a contractor I would submit it would be a minor repair, and in this case the basis for the tax on the manufactured panel

will not play a decisive role in his decision as to whether he should buy the components and assemble them through his staff, or whether he should buy the finished article from a manufacturer. The price of the product will probably make the decision, because he has to buy three different components, and this in itself may build up the price. So again the tax basis in the end may be exactly the same.

THE CHAIRMAN: If he bought from a manufacturer he would be paying tax and putting these things together and adding labour costs. The builder would not pay any tax as he acquired these things, but the builder, when he bought them from the contractor, would pay tax on the whole.

MR. MOLLER: The same as with a new building.

COMMISSIONER GRANT: There are three ways of going about this, as I see it. One is that he can buy them from the prefab manufacturer, which will take care of the erection as well; secondly, he can buy the product and do the erecting himself; or thirdly, he can pre-cast it on his own premises?

MR. MOLLER: That is correct.

THE CHAIRMAN: And if he chooses the third, he is in the same position as the manufacturer who makes his own forms, which we have a certain amount of trouble with. But he still has to be dealt with the same way.

MR. MOLLER: And then he pays 250 per cent on the labour. This is just a matter of arbitrarily setting a basis for the tax, because nobody could tell me that the 250 per cent set by regulation is arrived at on a scientific basis.

COMMISSIONER PERRY: It is a slight modification of the statement that your basic proposal solves all the problems. I think there will be some problems left.

THE CHAIRMAN: Mr. Coyne?

MR. COYNE: Then, Mr. Chairman, I was proposing to turn over several pages to page 50. I do not know whether Mr. Walls or any of the other Commissioners wish to ask some questions on this.

COMMISSIONER WALLS: First of all, I think some consideration should be given to paragraph 119, where they run into the same problem in regard to being held responsible under the present certificate. The vendor is responsible, or is held responsible, if he is given incorrect information by the person applying for exemption. What is the alternative to that? Who would you have responsible for this? You do not deal with that point, I think.

MR. MOLLER: I think the position should be the same as it is with anybody who falsifies a banknote or falsifies a cheque. This is fraud and the man who issues the wrong certificate should be prosecuted for fraud.

COMMISSIONER WALLS: But the point is, who should sue him for fraud?

MR. MOLLER: The State.

THE CHAIRMAN: He should be prosecuted by the State?

MR. MOLLER: Yes, definitely.

COMMISSIONER WALLS: Therefore the certificate should be made out to the State, and that would automatically put the responsibility on the State?

MR. MOLLER: That is correct. In fact, it should be a pre-printed certificate like the income tax form and should state exactly what would happen if you make a false statement.

THE CHAIRMAN: I seem to remember recommending that this be done with these certificates.

MR. MOLLER: I think we have a most unfair condition right now, which makes the manufacturer a policeman without giving him any policing power. It is like sending a policeman out naked without even a night-stick, in his law enforcement.

COMMISSIONER WALLS: That is quite correct.

THE CHAIRMAN: That is quite a picture.

COMMISSIONER WALLS: I would like to get your opinion on the next section. I would like to find out if you have an actual ruling, because this matter was raised before. This is paragraph 123. I refer to materials used in the construction of universities and schools. There has been some

doubt as to whether construction encompasses repairs as well. I notice that in paragraph 128 you apparently interpret that provision as not applying to materials used in maintenance and repair.

MR. SANDFORD: Paragraph 128 is a quotation from the regulations.

COMMISSIONER WALLS: The section of the Act merely states "for construction". Have you had a definite ruling?

MR. SANDFORD: This is a ruling.

MR. MOLLER: It is in quotation marks.

MR. SANDFORD: The quotation marks start at paragraph 125.

THE CHAIRMAN: There are quotation marks at the end of the sentence, but not at the beginning.

MR. SANDFORD: It begins at paragraph 125. The numbers should not have been in there. The quotation is from Bulletin No. 9, I believe, issued by the Department of National Revenue.

COMMISSIONER WALLS: So they have ruled on this. It seems to be a rather odd ruling. Perhaps I should not be expressing opinions.

THE CHAIRMAN: That is impossible.

MR. MOLLER: This is, again, the same thing. The intent of the legislation was not clear enough to permit the administration to deviate from the intent.

COMMISSIONER GRANT: I am certainly in accord with paragraph 131. I have personal experience in this connection. I do not think

we recovered 50 per cent of what we should have recovered, because of the fact that forms were not completed and filed as they should have been at the time.

MR. MOLLER: You have the same difficulty with the refund, of course, in respect of new buildings.

COMMISSIONER GRANT: It was new construction I was referring to.

MR. MOLLER: Mr. Grant's remarks are most illustrative of the need for a change as we have proposed.

THE CHAIRMAN: Yes; that would disappear in your proposal too, of course.

COMMISSIONER WALLS: With regard to page 46, is it not the fact that the Department of National Revenue has really partially solved your difficulty with the new refund application forms?

MR. SANDFORD: Is this with regard to schools?

COMMISSIONER WALLS: Yes. You are dealing with the refund on schools and with the difficulty in this connection. I understand that the Department of National Revenue have now brought out a new refund application form.

MR. SANDFORD: No, not to our knowledge. The forms they have brought out are for the fixed-price contracts entered into prior to June 14; but with regard to schools, they have not come up with

a formula other than the directive that they require detailed information as to the exact amount of tax involved with the schools.

COMMISSIONER WALLS: I was going to give you credit for your negctiations.

MR. SANDFORD: We hope to be successful, but our negotiations have not resulted in success yet.

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You say that you have been led to believe that the new form was going to take care of it?

MR. STEIN: For schools and universities. This relates to commitments prior to June 13.

MR. CHUTTER: This is in the mills.

MR. COYNE: There is the other point on page 48 where you deal with the exemption to municipalities. This, of course, I think, is a problem that the Commission has got under study in dealing with all taxation between governments, and this is only a part of it; and whatever the solution it will have to apply to all types of arrangements between governments.

MR. SOMERVILLE: We find that in some areas the municipalities like to enter into competition with the contractor because they can buy equipment cheaper. We don't think this is economic from the overall public interest; and also it steals a lot of our trade.

THE CHAIRMAN: You really put it on the basis of being unfair competition, don't you? It is unfair competition?

MR. SOMERVILLE: Yes, sir; and we do believe it is extravagent.

THE CHAIRMAN: Have you got something, Mr. Walls, or shall we ask Mr. Coyne to proceed?

COMMISSIONER WALLS: No.

MR. COYNE: Thank you very much, Mr. Chairman. If we could turn to page 50, in paragraph 140 you are dealing with the refund procedure for pre-budget price contracts. The final sentence in the

paragraph reads:

"In addition contractors will only be refunded an amount equal to 50-60% of their extra costs resulting from the new taxes due to factors such as trade mark-up, provincial sales taxes and tax free inventories as well as the interest on capital required while waiting for the refund..."

I wonder if you would explain this. I take it to mean that you are entitled to apply for 100% refund in taxes and that you are getting back something equivalent to 50 or 60%?

MR. STEIN: No.

MR. COYNE: Could you explain that -- how you come up with the figure of 50-60%?

MR. STEIN: The federal tax is collected by National Revenue at the manufacturer's level. In the construction industry very rarely is the material purchased directly from the manufacturer -- from the manufacturer by the contractor; there is usually an intermediary somewhere down the line -- sometimes several. National Revenue -- and rightly so -- must take into consideration that somewhere, between the time this material leaves the manufacturer's plant and ends up on the project, there has been transportation -- and sometimes freight can be a considerable factor -- there is the wholesaler or dealer who has handling charge and his mark-up, and this all ultimately appears in the consumer's -- in this case, the contractor's -- costs.

Now, in retracing these steps all these other factors are ruled out; so although on the material a price increase of "X" percentage is paid -- and bear in mind that the increase in federal tax comes through as an increase in price -- although the regulations say that the manufacturers should declare the value of the tax paid, they don't and they cannot be made to; therefore, in retracing all these steps it ends up as 50-60%.

THE CHAIRMAN: Because you can't find the tax?

MR. STEIN: You can't find the tax.

THE CHAIRMAN: And they won't disclose it because if they did they would disclose their market.

MR. COYNE: Really what you are saying, as I understand it, is that if the tax is applied between the manufacturer and the dealer the effect of that tax, by the time the material reaches you, is about double the effect of the tax?

MR. STEIN: Yes. The revenue to the Department is $2...

MR. MOLLER: This includes -- the $2 includes the interest on the waiting time for the refund and the administrative charges.

MR. SANDFORD: The Department of National Revenue calculate it to be about the same; and I think we are a little conservative in this, because they also took into account that there was a lot of tax inventory on hand at June 13, and when the tax went into effect the new inventory was there and the

contractor would have to pay. I think it is true that one dollar of tax equals about $2 of extra cost to the contractor.

These other things, Mr. Moller...

MR. MOLLER: These other things are very vague, but they are a very substantial part of cost to the contractor, which is not refundable because of the general circumstances.

MR. CHUTTER: The Department takes the view that it shouldn't refund to the contractor-owner money it did not receive at the manufacturer's level; and inasmuch as the pyramiding is about double, the contractors are hoping to get back maybe 40% to 50% of the extra costs they are paying.

This is hypothetical, because the refunds have not yet been processed.

MR. COYNE: If the tax is paid at the time the materials are sold by the manufacturer, say, to the wholesaler or dealer, then is it not the case that the dealer has paid the tax, therefore, the dealer has to make the refund for the tax?

MR. CHUTTER: No.

MR. SANDFORD: The first person in line, if it is a fixed price contract, which it is more often than not, is the contractor to the owner; but the supply of materials is not usually on a contract basis.

MR. CHUTTER: The result is that the manufacturer knows what the tax is, but the dealer doesn't -- the second or third intermediary doesn't

know what the tax is.

MR. COYNE: So that you have the problem of applying, in effect, for a refund of tax which you didn't pay and the amount of which you have no knowledge.

MR. STEIN: May I give this as an example -- and this goes back to 1960-61 -- that we were the general contractors in the construction of a building in which a great deal of production equipment had to be incorporated, such as process and handling units, humidity controls and extremely delicate temperature controls, all an essential part of the manufacturing process. The contract at the time of writing read "All taxes shall be paid, and the contractor shall assist the owners in their claim for a refund of tax which otherwise would have been applicable at the 11%." In due course the contract was completed and the owners engaged an excise tax consultant who spent exactly one year tracing through our orders through the wholesalers, sub-contractors, sub-sub-contractors, suppliers, sub-suppliers, and eventually back to one particular point where he bogged down after a year of work. He estimated that he had salvaged or reclaimed on behalf of the owners 75% of the tax actually paid on the value of these materials; and adding to that his fee of 30% of what was reclaimed, the owner received 50% of the tax paid.

To me this is a classic example. Now, you can multiply this many thousand-fold on the whole

refund procedure level, and it is appalling.

MR. COYNE: This would be cured under your proposal?

MR. STEIN: Yes.

THE CHAIRMAN: Mr. Coyne, have you much more on sales tax?

MR. COYNE: No, I haven't, Mr. Chairman. I have perhaps one or two questions only on the remainder of the sales tax.

THE CHAIRMAN: Perhaps we might go until about five past one. Perhaps we could clear this up.

MR. COYNE: The first question I have refers to paragraph 141 and is merely asked for clarification. You are referring to the fact that this tax relief of which you speak, on fixed price contracts, only extends to 1964, and then you say "Only contractors with long-term contracts with the Federal Governments are provided such relief..."

MR. SOMERVILLE: To the Federal Government -- there is no tax...

MR. COYNE: This is what really my question was. Would you explain the difference with reference to contracts with the Federal Government?

MR. CHUTTER: After the budget the Treasury Board brought out a directive, dealing, of course, with Crown contracts, which has the effect of permitting the contract amount to be adjusted upwards to cover the cost of the tax to the contractor on a long-term contract. There is no time limit. So,

for example, the National Library and the MacDonald Cartier Bridge which extend into 1965 receive relief throughout, but the Toronto subway contract, the Peace River contract and Toronto City Hall and others, which are also long-term contracts, because they are not for the Crown no relief is provided until after 1964; and on the major contracts the extra cost, as you will appreciate, is extremely large.

MR. COYNE: In other words, the Federal Government has a contract and it has said to the contractors "We will pay you additional amounts for any tax you are required to pay in the case of these fixed price contracts"?

MR. CHUTTER: They are getting compensation for the tax but not for the pyramiding of the tax; they are getting compensation or relief right through to 1965-66.

THE CHAIRMAN: Who pays the tax on the T.T.C. contract?

MR. CHUTTER: The contractor has a lump sum contract.

THE CHAIRMAN: And he gets relief for [illegible]

MR. CHUTTER: He gets relief until the end of the current year, but not for any material -- work -- done in 1965.

THE CHAIRMAN: Is he committed beyond the current year?

MR. CHUTTER: They were committed just before the budget came down.

THE CHAIRMAN: And he is going to have to pay the tax beyond the end of the year.

MR. COYNE: The only other question I have on this aspect of it, Mr. Chairman, is a along at page 56 where the brief is dealing with provincial sales taxes, and there are some suggestions made -- recommendations -- in paragraph 156, the third of which is:

"If the first two cannot be achieved then there should be standardization of the sales tax legislation, regulations and administrative procedures in the various provinces of Canada..."

I am sorry; the recommendation that I really wanted to query you on was No. 2:

"If a sales tax is to be imposed it should be through a single taxing authority with the proceeds distributed amongst the provinces and with the Federal Government according to a pre-arranged agreement..."

I wonder if you would care to amplify the thought you have in mind there, particularly bearing in mind that the present sales taxes in the provinces are levied at retail sales taxes, whereas the present Federal sales tax is, of course, the manufacturer's sales tax.

MR. MOLLER: Well, I think this, perhaps, requires some explanation. This is presupposed on the assumption that the manufacturer's sales tax will be finally converted into a consumer's

tax on the end instead of the beginning; and whether it will be relatively on the same basis as for the exacting of provincial taxes, under a different name -- and in this case it could be possible, perhaps, to have one taxing authority -- federal or provincial -- with rates to be established by the individual authority -- federal and provincial -- as is now the case in income tax, and being collected by only one authority and ordered by only one authority, but distributed amongst the participants in accordance with their tax rates in this province or that province plus the federal rate.

MR. COYNE: This aspect was quite clear, but I take it that what is implied here is that you are suggesting that our sales tax should be imposed at the same level?

MR. MOLLER: Yes.

MR. COYNE: Which is presumably at the retail level rather than at the manufacturer's level.

MR. CHUTTER: Well, actually, our example was Quebec; but most of the municipalities have a sales tax.

MR. STEIN: It is collected by the province.

MR. COYNE: But on behalf of the municipalities?

MR. MOLLER: There are different rates. You have each of them enumerated, and it shows six, or five or four.

MR. COYNE: Thank you very much. Thos-

are all my questions on sales tax.

THE CHAIRMAN: I think this might end our session on sales tax. I would guess that the income taxes and estate taxes that you have not come to yet might take us an hour or an hour and a half. Do you think that would be about right, Mr. Coyne?

MR. COYNE: I think it would.

THE CHAIRMAN: Then, we will be back at 2.30 unless you people are in a hurry to get away this afternoon.

MR. SOMERVILLE: No, Mr. Chairman.

--- Luncheon adjournment.

MR. COYNE: Mr. Chairman, I think before we went forward to the sales tax section we were in the introductory part of the brief at page 6. Many of the points here in this section we will pick up in the later sections, of course. On page 8 there are one or two paragraphs which perhaps we might deal with now.

THE CHAIRMAN: This is the summary, is it not?

MR. COYNE: Yes.

THE CHAIRMAN: Do you prefer to deal with this in the summary?

MR. COYNE: There are a few points which I think we can more expeditiously, perhaps, dispose of here. In paragraph 7 the brief states:

> " Canadian corporation and personal income tax rates and deductible allowances should be such that the effective rates are not higher than those in the U.S.A. and delays should be avoided in following U.S. action in putting tax cuts into effect."

You deal with this same subject further on in paragraph 90 on page 33. I wonder if you could expand a little on your thought here. Is this to suggest, in effect, that Canada is not free to set its own income tax provisions, that it should look to the United States for this purpose?

MR. SOMERVILLE: Not at all. The reason for this is to ensure that we are not put into

a bad position competitively when they put their new taxes into effect. In other words, to look at our taxes in such a way that they do not affect the cost of the goods which we produce when their taxes drop.

MR. COYNE: Are you thinking of taxes imposed on business rather than personal taxes?

MR. SOMERVILLE: I think both taxes are mentioned. The competitive aspect, of course, is the corporation.

MR. COYNE: In paragraph 9 there is a relatively small point. You recommend that:

> " An executive using his own car on company business should be reimbursed for its depreciation without attracting tax."

As I see the statute at the moment, under subsection 11 of Section 11 of the Income Tax Act, if an employee is one who is entitled to deduct travelling expenses for tax purposes, he is specifically permitted also to deduct capital cost allowance. It is not clear what you are suggesting, whether he should, in addition to that, be entitled to receive the amount of the depreciation without paying tax on it.

MR. SOMERVILLE: I will have to hand that over, I think.

MR. GRAY: I think that what we have in mind is that an executive who used his car rather infrequently but had to maintain a car

out on the front lot in case he had to take anyone around should benefit from this. You are allowed 10 per cent a mile travelling allowance if you have a car for such purpose, but there is no way of reimbursing you for providing the car. They are taxing their salary from which you buy a car. In other words, it is putting it on the same basis as a company-owned car.

THE CHAIRMAN: I should have thought that if one is reimbursed for the use of his own automobile that would be part of his income and he would then wish to obtain a deduction from that income for the expense of his car.

MR. GRAY: He could not.

THE CHAIRMAN: He could not because he is an employee?

MR. GRAY: Yes. However, it is not an important point as far as we are concerned.

MR. COYNE: I imagine that it involves an extension of subsection (9), which limits the deduction of travelling expenses to employees ordinarily required to carry on their duties of employment away from the employer's point of business.

MR. GRAY: They should have the privilege either of accepting the ten cents a mile and take depreciation of it, or otherwise take the depreciation out of his income for tax purposes.

MR. COYNE: Is there any way in which you could determine whether the car was indeed a proper business asset of the employee, or whether it

was not essentially used for private purposes?

MR. MOLLER: Could I just add to this that actually the same criterion would apply as applies when the Department requires the adding back of some car expenses to employee's income. That would apply even to a doctor's car or a lawyer's car. It would make it simpler and I should like that this point in our presentation be not stressed, because it is really a minor one. All we are aiming at, on the recommendation of some of the members of our Association who requested we put it in, is at an equality of treatment of an executive with that of a professional man, for argument's sake.

THE CHAIRMAN: If you are going to do that, you will have to change quite a lot of things. If it is done in the construction business, obviously it should be done in a great many other businesses too.

MR. MOLLER: Except that I would suggest that the construction business, by its very nature, requires a lot of travelling, say, of executives which other businesses may not to the same extent. But again I would not like to dwell on this point too much because it really is of minimal importance.

THE CHAIRMAN: Then if you do not wish to pursue it, Mr. Coyne, we can skip it.

MR. COYNE: I was proposing to go now to page 15, which is in the middle of the second section of the brief, but still dealing with general principles of taxation. You are making comments in this part of the brief on the desirability of

certainty, and you are criticizing the reintroduction of ministerial discretion. The final sentence in paragraph 30 on page 15 reads in this way:

> "It is respectfully submitted that Section 138 provides the government with sufficient power to set aside transactions with prevalent tax avoidance intentions".

I take it from that that the Association is in favour of the retention of Section 138?

MR. MOLLER: In preference to ministerial discretion, yes. That is clear. We do not worry about the fairness of Treasury Board, but we do worry about the possibility of some minor official exercising really the minister's discretion.

THE CHAIRMAN: I think it has been pointed out by the Minister that Treasury Board does not operate in this manner, but obviously if the Treasury Board was serious about it they could set up a sub-committee to get it going.

MR. MOLLER: It is really a question of who exercises the discretion. We feel that a sub-committee, to follow the suggestion of the Commissioner, would be safer to look to for fair, equitable and reasonable treatment than some minor officials who are scattered all over the country in district offices, who actually exercise ministerial discretion, as we all know.

MR. COYNE: Then if we could turn to the more specific parts of the brief, the section on present taxes and recommended changes commences at

page 21.

THE CHAIRMAN: Does that mean that you have covered everything up to this point, Mr. Coyne?

MR. COYNE: I have, unless there is some question which you or the other Commissioners might want to ask.

MR. GRANT: There is just one point with regard to the losses which it is suggested be granted on a carry back privilege of four years.

MR. COYNE: I think that comes up, Mr. Grant, in this part of the brief at a later stage. Turning to page 22, a very small point in paragraph 52. You point out that by contrast with Canada the United States Federal Government imposes no sales tax on building materials. I suppose it is fair to point out that the United States Federal Government imposes no sales tax on anything. I do not imagine that you are suggesting that this is particularly a difference in the field of building materials, because it is a difference throughout the field of consumption taxes.

MR. MOLLER: Would it be fair to say that up to the point where sales tax was not imposed on building materials, the situation was the same here as in the United States, and through the newly-imposed sales tax the situation has been changed now?

MR. COYNE: As far as building materials are concerned, yes.

MR. SOMERVILLE: This paragraph ties in with paragraph 9, page 4, which says:

" At the present time, construction projects and construction companies are subjected to a multitude of taxes and assorted imposts levied by the three levels of government in Canada. In both cases the tax burden is heavier in Canada than in the U.S.A."

THE CHAIRMAN: That is a summary of what you have put.

MR. SOMERVILLE: Yes.

MR. COYNE: Then on page 22, paragraph 55, you acknowledge that a number of your recommendations would involve a reduction in Federal government revenues. It says:

" In line with the Royal Commission's terms of reference concerning the maintenance of adequate tax receipts, it is suggested that greater attention be given to the area of selected consumer goods and services as being more appropriate for tax attention than those aspects of the economy related to the production of goods and economic expansion."

I wonder whether you would care to explain a little of what you have in mind there concerning the greater attention to the area of selected con-

sumer goods and services. I take it that you are speaking in terms of broadening the existing tax base, rather than increasing the rates of tax?

MR. MOLLER: Yes.

MR. COYNE: Could you develop your ideas as to how this tax base should be broadened?

THE CHAIRMAN: Particularly having regard to the word "selected", which I do not understand.

MR. GRAHAM: We had in mind there that the base must be broadened definitely to recuperate those taxes which might otherwise be derived from taxation of capital growth. We have in mind, therefore, a general broadening of the tax base into services, perhaps, not necessarily with regard to income tax, but perhaps a broadening so far as sales tax is concerned.

MR. COYNE: What kind of services? Is it possible to be a little more specific about that?

MR. GRAHAM: Services such as laundry, dry cleaning, automobile maintenance, barber and beauty parlour services, hotel and motel accommodation, storage of property.

MR. COYNE: Would you think in terms of the tax being imposed on a list of services specified in the statute, rather than under overall terms, simply of a tax on services, which I presume might well include contractor services amongst others.

MR. GRAHAM: Yes, it would have to be specified.

THE CHAIRMAN: The list which you have just indicated to us I do not think would produce a very great deal of money. I have seen a tabulation of it, but I cannot remember what it is.

MR. GRAHAM: I cannot commit myself to it either. We have not a definite calculation of the revenue which would be derived.

THE CHAIRMAN: I should not think that that kind of calculation would make up for very much loss, but there are a great many services which you would not go into on the basis you are speaking about, such as interest. France, for example, taxes interest on all services, which covers a very broad area indeed. Insurance is also another fairly broad area.

COMMISSIONER GRANT: There is also the public utility field.

THE CHAIRMAN: Yes, the public utility field. Then there are such things as telephone bills, power bills, and so on. Would you go into those areas as well?

MR. MOLLER: Such matters as telephones and transportation have been subjected at times to a sales tax anyway.

THE CHAIRMAN: I think they are in certain places now.

MR. MOLLER: Yes. I think that is so in Prince Edward Island, but that is certainly a very

broad basis which is relatively easy to collect, yet is small enough not to hit the individual too strongly as compared with an 11 per cent tax on materials or capital expenditures.

MR. COYNE: Let us turn for the moment from services to goods, because you also make reference to selected consumer goods. Are there any goods which are not being taxed at the moment that you feel should be added to the taxable list?

MR. CHUTTER: Would it be possible, first of all, to refer to the remark which was made about interest rates? We have earlier in the brief suggested that there be a conciliation between consumer services and what might be described as capital services, services performed in acquiring capital assets. We should like to retain that distinction in the services field as well as products, as discussed this morning.

So far as consumer goods are concerned, I know that at our own committee meetings there has been a lack of any desire on anyone's part to point the finger at anybody else and say that they should be taxed, not us. It would be pretty hard to say that anything in Schedule 3 should be taxed, although I think it could be argued that there would certainly be as good an argument for exempting capital goods as some other goods which are still exempted from the Federal sales tax.

THE CHAIRMAN: If you are thinking of interest, there is no reason why interest should not

be treated in the same way as goods, and that is, if you have an exemption or a licence you would not pay tax on that. But the consumer public would pay tax.

MR. CHUTTER: As long as this distinction is made. Some of these other professional fees, for example, you could have a line of demarcation for legal fees or even professional accountants fees which are involved in the development of a project, which might be one thing as opposed to legal fees connected with ordinary business services not attached to capital. Whether you can go that far is a moot question.

THE CHAIRMAN: Many companies exempt them because a large proportion go into the kind of things which you speak of. But if you are going to licence everyone engaged in productive activity, there is no reason why they should not be taxed as in the case of a licence.

How about the selected goods? Let us see if you can find some more goods to tax.

MR. MOLLER: I know that this would be unpopular, but a small tax on foodstuffs would probably bring in a very large amount. It is easy to collect and not too large a burden, and a tax of one or 2 per cent on staple goods would probably bring in a very large sum. I have not tried to assemble any statistics, which are probably available to the Commission anyway, but it would bring

comparatively large returns, although it may be politically not feasible to implement such a tax.

THE CHAIRMAN: Yes, I see the point. If one taxed food and clothing, then housing would be a natural.

MR. MOLLER: Yes, that cannot be denied. But the question then becomes one of rate. If these essentials should be taxed, they would have to be taxed at a very small rate, but it would still bring in a very large sum of revenue to the government.

THE CHAIRMAN: I have often wondered how one could approach this, so that at the essentials level they are not taxed, but beyond that level they are taxed. The Canadian Labour Congress suggested that rates of consumption tax should be in some way graduated, so that if you bought a Ford motor car you paid one rate of tax and if you bought a Cadillac you paid another rate of tax. What appeals to me is that if you consume 1,500 or 1,200 calories a day you pay one tax; if you consume 2,500 calories a day you would pay more by way of tax as your consumption goes up.

COMMISSIONER GRANT: I imagine that a man swinging a pick might object to that. He has to eat more.

THE CHAIRMAN: He probably eats a great deal more than he should anyway. It seems to me that there is more sense in trying to find a level, or a brake in the rate of expenditure, than

it is in choosing goods, because who can say when a car is essential and when it is not essential? That is what we try to do all the time and it is a very difficult thing to do.

MR. COYNE: In the next paragraph on the same page, paragraph 56, you make some quite general comments about government expenditures, including the statement that:

> "The containment and, where possible, reductions in government expenditures are receiving increasing attention, and it is urged that further efforts be made in this direction on a continuing basis."

I realize that that is a general statement, but I put it to you that one of the great sources of increasing government expenditure to this date, and one of the sources of increasing government expenditure undoubtedly in the future, will be the heavy demands for public construction on schools, highways, and universities, and on all manner of social capital, if you like, to use the term Mr. Chutter used this morning.

For example, I note that in your Appendix "A" showing the trend in private and public construction investment for the six years 1957 to 1963, whereas private construction investment has remained remarkably constant, public construction investment has advanced by a total of 20% over that period of years.

Would it be fair to say that what you are really saying here is that if there are some government expenditures which can be reduced, they should be reduced; but there should not be some over-all blanket ceiling or percentage reduction?

MR. SOMERVILLE: I think that without saying it, we are perhaps referring to the Glassco Commission report with regard to the economies that can be exercised in government.

MR. CHUTTER: Even within the realm of construction one of our arguments for encouraging private investment is that this would relieve pressure on governments to sort of fill up this slack which is increasing at all levels. But even with the government construction programs there have been some improvements towards economies in administration; and others have yet to be acted upon.

As an example, their contract forms were very invidious. This made government construction much more costly because contractors tried to cover themselves. The new ones are better. There could be a greater use of the contract method by the

federal and other governments. Then there is the consolidation of the 22 or 23 construction agencies in Ottawa in the federal government into three or four, which would effect, it is felt, considerable economies and would reduce government expenditures attached to them.

Then there is the question that all construction projects receiving substantial federal grants should have as a requirement a public tender call and a public tender opening, which might well result in a few economies. There are a number in this field, even within the construction sphere, that could lead to economies.

MR. SOMERVILLE: We saw a recommendation the other day in the City of Toronto that they sell their ready-mix plant because they can buy concrete cheaper from private sources. That is the sort of economy that could be exercised at all levels of government.

MR. CHUTTER: We are advocating to the Treasury Board now that they re-institute the practice of allowing contractors to use government of Canada bonds as security deposits on their projects. This used to be the case but it was cut out three or four years ago. The National Art Gallery here, for example, the contractor was able to use government bonds. This gave him a $40,000 advantage over competitors, who had to use the mandatory type of security deposit required by the

Treasury Board.

We feel there should be changes in the contract procedures, and if you multiply that over the whole field it adds up to a fair amount of money.

MR.COYNE: In other words, the costs of government might well be reduced by more efficient organization; that is, in substance, what you are saying?

MR. CHUTTER: Yes.

MR. COYNE: Then we get into the part of the brief that deals with federal income tax. The first specific matter that you deal with has to do with capital cost allowances, in which field you make a number of suggestions. For example, inparagraph 64 on page 24 you say:

> "In order to facilitate a general economic expansion, the Association has recommended that capital cost allowances in the business investment sector covering all new fixed assets generally be increased and that capital outlays for industrial plants specifically may be written off entirely in any five of the initial eight year period."

In other parts of the brief you also deal with and recommend, perhaps in general terms, methods of accelerated depreciation. My first question

is simply whether or not you agree that the capital cost allowance system itself represents a method of accelerated deprecation?

MR. CHUTTER: The principle has an element of that in it, certainly.

MR. MOLLER: But it does not permit you to write off equipment that you do not have any more. That affects the construction industry particularly, where they completely eliminate some part of the equipment. You still keep on writing it off as a class; you cannot eliminate it. You cannot get reimbursed for your loss at the time it happened, but you carry your loss forward and diminish it. But it takes you several years sometimes to get rid of the item, in effect, from your books.

THE CHAIRMAN: I do not follow you, Mr. Moller. You mean that you cannot get a terminal loss because you have some item left?

MR. MOLLER: If you continue the class, but you cannot actually dispose of the item. You are forced really to sell it as scrap to even get it recognized as a loss.

THE CHAIRMAN: Are you aware of any cases where the net amount of the asset, after deducting capital cost allowance, has gone up over a period of years? That is, you are taking assets in; you are taking it out of capital cost allowance, and if your capital cost allowance is inadequate it would mean that your write-off would be insufficient

to bring it down to where you were going to realize on it, and therefore when you realize on it, whatever you get is credited to the account and it is not enough to write-off the balance. This is reflected in the reserve to maintain your equipment, and the net effect is that the net balance would go up, instead of going down, would it not, over a period of time? I would not have thought that would occur.

MR. MOLLER: The effect depends very much on the type of business. In the construction industry you may in one year have a need for a great deal of equipment, which you may not need the next year. But if you do not want to realize a loss by selling it, and you maintain it, it has lost much more value than the 30%.

THE CHAIRMAN: I have read the illustration you have put in here, but that is a very aggravated case, because you held it for two years and then only got its scrap value. That could certainly happen on a tough construction job, such as in the Rocky Mountains, where the equipment is working 24 hours a day, or something like that.

MR. MOLLER: Or, as we had in one case in Baffin Island, the equipment was to be shipped after it had been used there for a while. The shipping costs are prohibitive to bringing it back, even if it is usable, so you are very happy if you lose it.

THE CHAIRMAN: You could not get a terminal loss on it if it was still there?

MR. MOLLER: Yes.

MR. COYNE: I interpret your criticism as being not so much directed at the system that is provided by the statute, but it is with the regulations, in the sense of dividing assets into classes.

If there were more of the classes more directly tailored to the particular circumstances to which you refer, then the difficulties would not arise?

MR. SOMERVILLE: And the rates are inadequate in some cases. There are many items that are in the class where they have to be depreciated that really should be written off as purchases. I refer to smaller items and short-use items.

MR. MOLLER: You have the choice only on small things, up to $100, to put them in class 12 now and write them off immediately. Certain types of construction equipment which are of much more value should be allowed to be carried into another class or should be allowed to be written off when the job is finished.

MR. COYNE: I appreciate your point on losses, which is really a criticism of the system of the classes that now exist, and I take your point about rates, which you say are not large enough in respect of certain classes.

But am I right in thinking, in view of your general support for the methods of accelerated depreciation, that you support the diminishing balance

system in the capital cost allowance system, in preference to the straight line system that we used to have before?

MR. SOMERVILLE: Yes. The only thing we do not like about it is that the new diminishing balance rate is not high enough to make it attractive.

THE CHAIRMAN: I think the illustration you have given here must be a pretty bad one; but if instead of 40% it were 30%, and you recovered 30%, you would write off 70% in two years and, on these figures, you would be short 6%. That would not have been very serious, would it?

MR. SOMERVILLE: We would also like consideration to be given to equipment that is used on a two or three-shift basis, as opposed to a one-shift basis, on jobs.

THE CHAIRMAN: You are going to get into an awful lot of trouble with that.

MR. SOMERVILLE: You do, but you get into an awful lot of trouble losing money on your equipment because of the lack of this. It is particularly important when you get up into the north country, where you get into very hard rock and work long shifts at the end of the period. A piece of equipment has to be really rebuilt so that you can bring its value back up again, rather than throw it away.

THE CHAIRMAN: If you did that you would have to have separate classes and as soon as you

stopped using it in two shifts you would have to put it back into the first class again. I think you would give that up pretty quickly.

MR. MOLLER: You had better raise the rate.

COMMISSIONER GRANT: You have probably read the brief of the Heavy Equipment Association of B.C. when they made representations to us.

MR. MOLLER: The rate on machinery was raised from 10% to 20% by switching to the diminishing balance system. But this was moved, not to 40 or 50%, but only to 30%.

THE CHAIRMAN: I do not know why they did not proceed with it before, but I suppose they thought the rates were too high.

MR. MOLLER: If you will permit a strong expression, the raising from 20, 25 to only 30% is almost a discrimination against the contracting equipment, because this is the bulk of it.

THE CHAIRMAN: I am not sure that is right, because you have a pretty substantial write-off here. At 20% it would take you two and a half years to get down to that point on the straight line basis.

MR. MOLLER: But you had 25% at first.

MR. COYNE: I see, Mr. Chairman, that we started out by dealing with capital cost allowances for owners, which is dealt with on page 24, and we have now in fact got into capital cost allowances

for contractors.

Could I just pick up where we were. I refer to page 29, where in the last sentence of paragraph 78 you say:

> "Such equipment might be permitted to be written off in three years with a straight line rate of 33-1/3% or in five years with a limitation of 33-1/3% in any one year.

Perhaps this just displays my ignorance of accounting, but would you explain what you mean by this second alternative, "or in five years with a limitation of 33-1/3% in any one year".

MR. MOLLER: This goes back to my first statement that the construction industry has a lot of heavy equipment, and if you do not get a contract where you can use it, you are not making any money. You have no recovery on depreciation, so you choose not to depreciate the equipment. In the third year, if you have a contract for it, you use the heavy equipment. Taxed on the straight line, you are not limited to do it every year in succession three times, but you get a choice to have intermittent years where you do not depreciate it at all for one year, and the next year it has 33-1/3%, as long as that does not go on ad infinitum, because if it goes on ad infinitum that equipment has a much greater rate than it warrants.

MR. COYNE: But in either case you are proposing the introduction of a straight line --

MR. MOLLER: No. It should be a class like fishermen. This type of equipment is intangible; there is a choice. Once you have chosen it, you have to go through with it. This special equipment could go into a special class which could be treated on the straight line basis. If I correctly understand the new income tax regulations, we will have separate items for Canadian industries which can be written off in a special class, which has not yet been determined, but it will be written off on a straight line method.

THE CHAIRMAN: Subject to recapture?

MR. MOLLER: Yes, I think it is reasonable to assume it is subject to recapture.

MR. COYNE: Reverting, if we can, to page 24, at the bottom of the page you are speaking moregenerally and you recommend that capital outlays in industrial plants specifically may be written off entirely in any five of the initial eight year periods.

Is this merely an extension of the same sort of thing that we have been speaking about, but applicable generally to industrial plants?

MR. SOMERVILLE: There is a provision that equipment can be written off in two years, under the new regulations.

MR. COYNE: Under the special circumstances to which the new regulations apply? You are speaking of the 1963 provisions?

MR. SOMERVILLE: Yes. We feel there

would be an incentive to industry to build new facilities and improve their existing facilities if they were allowed to write-off at a faster rate.

MR. COYNE: And, again, on a straight line basis. You say they should be written off entirely in any five of the initial eight year periods.

MR. SOMERVILLE: Yes.

MR. COYNE: I suppose if there were a regulation of this kind it would drive a pretty large horse and carriage through the capital cost allowance system. This would be writing off and putting back into a straight line system, at the option of the taxpayer, a very substantial amount of depreciable assets.

MR. MOLLER: But that is already done, is it not, in the new legislation that has just come in?

THE CHAIRMAN: To a limited extent.

MR. MOLLER: Limited to Canadian companies.

MR. COYNE: And a time limitation of three years.

MR. CHUTTER: If you are in a depressed area the building can be written off in five years, and after the initial three-year holiday the building is entirely written off in five years, whether it be commercial or industrial.

This recommendation is of long standing

with the Association, and the real basis for it is twofold. One is the very substantial drop-off in construction outlays by manufacturers on the one hand and the feeling on the other of the great stress on increasing the need to provide job opportunities, brought out by the Senate Committee and other groups which have been delving into this problem, in which manufacturing and construction have been the main areas, plus services, to provide these new jobs.

If something was not done to try to make it more worth while financially for manufacturers to undergo new capital expansion there is going to be a very serious amount of short-changing, and with regard to the manufacturers themselves, their reasons for deciding whether or not to go ahead and plan for an expansion are of course based on many factors. But if they can see their way four or five years ahead with a market and they think they can compete, and the rest of it, they would be much more likely to plan for expansion than if they have to contemplate, "We will not be able to get our planned investment back for so many years, and we are not sure it is going to happen".

If they could realize a greater amount of their capital outlay in a faster period, they could do this. This seems to be a pretty important factor in their decisions to go ahead, and the Association has recommended that, in effect, an opportunity be provided in the field of manufacturing

industry in regard to their capital requirements.

THE CHAIRMAN: Have you any idea what the cost of this would be?

MR. CHUTTER: The volume of construction for manufacturers has been running at about $415 million on average in the last three years. It has been increasing somewhat in the last two or three years. From that we feel it would not apply to a good deal of it, because it might be just putting in new equipment as opposed to building a new plant. There would be variables attached to it.

MR. COYNE: When you use the term "industrial plant", I take it you are referring to physical construction rather than plant in the sense of mechanical equipment.

MR. CHUTTER: Yes, this is related to the building shell.

THE CHAIRMAN: The building only?

MR. CHUTTER: The building only, although in some types of industrial construction there may not be a building involved. In other words, it may be a chemical plant, or something like that, being reconstructed.

THE CHAIRMAN: I am just afraid that people will conclude, because this is only a deferment of tax, that it does not cost anything; but the cost, of course, is the interest on the money that the government would receive, under present practices, which it would not receive here.

I would suspect that these things are much more costly -- I do not really know -- and one might suspect that it would affect some decisions but it would not affect a great number of decisions. Whether or not it affected the decision, the man would get the benefit.

Is it a good idea for you and me to increase our taxes because of some decisions that would be affected by this? It has been represented to us that the cost involved in a move of this sort would be out of proportion to the benefits.

MR. CHUTTER: We have tried to give some consideration to this, taking it from the standpoint of the federal government's position that it may have to borrow more money to operate than otherwise would be the case if it granted accelerated write-offs, because there is a deferment of the tax payment as a result, so there would be the interest on the extra borrowing that the federal government might require to make.

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Our people, I think, have been concerned by the statements of their manufacturing clients, with whom they are trying to develop business, the importance of not only tax rates, but, on the other side, as to what are the allowances before the taxes are applied, and the need of an incentive to encourage them, if you will, to expand their plant facilities; that if there isn't an incentive provided of a pretty impressive nature then the Government would not then have the widest tax basis from which to collect the income tax on which they are relying. In other words, if industry doesnot expand then the Government are going to lose out on the revenue that they get from income tax from those businesses. And if you compare the potential loss with the interest on borrowing, we feel that the one would probably outweigh the other appreciably.

THE CHAIRMAN: The amount of funds that the Government would be out per annum would apply generally in specific areas. Certainly one can get some indication of the difference by what is claimed for ordinary credit purposes and capital cost allowances claimed for tax purposes. This always shows up on the balance sheet of a company; and if they were to use your procedure and added the reserves which represent monies which the Government has not got because of the higher rate of cost allowance and the rate of interest on that, which is what the Government is out, it is a very substantial sum annually; and if you extend that, what

you are saying is that the capital cost allowance is not general. If you do that you are going to add an awful lot of cost to the Government for something that you don't know -- what the losses are going to be.

We have had it said to us by people that they are getting disillusioned and that capital cost allowances are a very poor substitute for lower taxes; and you are going to get into a lot of money.

Almost everybody comes before us and says "Why not reduce taxes instead of having this sort of thing?" I was looking at the summary of the evidence and it says "Tax incentives should not be used..."

MR. MOLLER: May I submit, following the Commission's argument, that the amount of money which is being deferred by capital cost allowance incentives has to be raised. The question, then, perhaps, which one might ask is: Who borrows money cheaper? The Government borrows money cheaper and easier than industry; and if you take it, then, that the 6% which industries would have to pay on the amounts which are deferred, assuming that they have to be borrowed, then this would increase the profit margin by the Government by 50% right away.

THE CHAIRMAN: You have got a point there, Mr. Moller; but you have also got to remember that the weight of the tax has to be distributed in the fairest possible way. What you would be doing in having such a system, having regard to the capital or business -- suppose a company hoped to build a new

plant, but they never do it. Isn't the result going to be to increase the taxes to the industry also? Is that going to be good for the economy?

MR. MOLLER: I think the question could be asked whether this is not partly artificially conditioned by our way of accounting for Government expenditures.

Our budgetary system, of course, has -- perhaps we could say this -- has not been changed radically or basically in the way that accounting for Government expenditures has been conducted, whereas our other systems have been brought up from the point where the balance sheet is subordinate to profit and loss accounts in importance. This is not the case with the Government; and it is really a question, on budget deficits, whether it is true, in fact, that they are deficits, because in many cases if the Government was working as does private enterprise -- let us say, in the utility field, if private enterprise would still be running the utility it would be depreciating and would be capitalizing for new plant and it certainly wouldn't show it as a deficit. If the Government does the same thing it shows as a deficit; and we talk about big deficits which, in effect, may be nothing else than capital expenditures to be ammortized in the future.

THE CHAIRMAN: Even if we should agree with you and think that deficits are quite illusory we are still faced with our instructions for this job, which is to maintain the revenue.

MR. SOMERVILLE: One point that didn't come up in this connection, when talking about sales tax, is that the additional cost of sales tax requires people in business to pay interest rates on the additional monies they have to borrow.

THE CHAIRMAN: I agree with that.

MR. MOLLER: We have to inject into the cash flow the full amount of sales tax added to our otherwise existing bills; and particularly so far as business is concerned we are paying the money out and if we are lucky and get a refund -- which, as was pointed out, won't be a hundred per cent, and we won't get anything if these monies are paid to the Government wrongly, or, really, not lawfully -- if it is income tax we get 3% back, I think, but I am not even quite sure it gets that far. There is no refund for industry at all, so this is an outright loss; but there is, I would say, an innocent party because the contractor certainly is unable to collect it from the owner, because the owner says "You are entitled to a refund; ask for a refund." He has to lay it out. He doesn't get it back in full; and to stay in business he has to borrow money to finance, which is a hardship.

This seems to me an easily-overlooked item which is of the greatest importance. We were talking about $185,000,000 at one point today in this hearing, of added taxes, and these are not small sums.

THE CHAIRMAN: We are not overlooking them, I can assure you.

MR. COYNE: The next point I was going

to turn to is a relatively small one on page 27 where you are dealing with major repairs in paragraph 71. You say:

"At the present time taxpayers have the option of considering major repair and replacement expenditure to buildings as either a current operating expense or as a capital item that usually has a capital cost allowance rate of 5%..."

Is that, strictly speaking, correct? I thought the jurisprudence was strewn with decisions where the taxpayer thought he had the option but he found he was wrong.

MR. MOLLER: If I may say something off the record...

THE CHAIRMAN: It is hard to do that because there is a reporter here.

MR. COYNE: I want to go on to the second sentence where you make this recommendation:

"It is believed that there should be a further option available between these two extremes and it is recommended that such outlays be also allowed to be written off over a period of not exceeding 5 years."

Do I understand that to mean that, in effect, you are proposing another separate class?

MR. MOLLER: Yes.

MR. COYNE: To accommodate repairs?

MR. MOLLER: Major repairs.

Mr.COYNE: Major repairs which would be depreciable on a straight line basis and over a period

not exceeding five years?

MR. MOLLER: On the assumption that the major repairs are not adding to the capacity of the plant they have to be written off now, in the year in which they are expended.

MR. COYNE: But you are recommending a straight line method at the option of the taxpayer? He would still be entitled to capitalize them in the ordinary fashion, but you are recommending...

MR. MOLLER: As you have pointed out the wording here is a little loose -- that the taxpayer has the option. The taxpayer has a choice. He can represent the undertaking or the construction as a repair or as a replacement; and depending on how he presents it, if the tax department accepts his representations then he has theoretically speaking a choice.

MR. COYNE: Well, I don't know; I think this is a legal point. I think under the law certain expenses are entitled to be deducted as current expenses and other expenses are entitled to be considered as capital expenses and not deductable. I take it that what you are dealing with here is an alternative method of writing off the whole cost?

MR. MOLLER: I would say it is a question of major repairs and that the taxpayer be given the option of deferring the expense for tax purposes over a period of five years.

Let us for one moment assume that we are talking about an expense which the tax department would acknowledge.

THE CHAIRMAN: You are thinking of bad debt expenses which under the present system are not allowed?

MR. MOLLER: Not allowed.

MR. COYNE: And is it not rather the expenses that are properly subject to capital cost allowances that you are concerned with?

MR. MOLLER: Yes, that is right. The question is, then, of course, as a practical solution why not have something which is definitely allowed as an expense to be an expense. Take a company painting a big plant. You don't paint it every year. So if you paint it in 1963 1963 it is; you would have to write it off in that year.

In order to smooth out the results it would be desirable, I submit, that a way should be found to openly and quite legally defer for tax purposes the claiming of this expense, which actually means that the department would get more tax in the end effect.

THE CHAIRMAN: And the averaging procedure then wouldn't be necessary?

MR. MOLLER: That is it exactly. It is almost an alternative, or a part alternative, to the averaging procedure.

MR. COYNE: I wonder, Mr. Chairman, if we could go on to one of the major subjects that is remaining, and that is in the section commencing at page 30 on the subject of reporting of income. This is divided into sections entitled "Holdbacks" and "Income Fluctuations." I thought...

THE CHAIRMAN: So far as these gentlemen are concerned there is nothing much more important. They are very much concerned about this.

MR. COYNE: I thought it might be helpful, as an introduction to this subject, if we asked Mr. Somerville and his colleagues simply to outline very briefly how contractors would, in fact, account for the various ways in which they account for income within the congines of the Income Tax Act at the moment.

MR. SOMERVILLE: We would be glad to do that.

MR. GRAY: A few years ago we conducted a survey and found that about 50% of the general sub-contractors reported on the completed contract method. In other words, only at the end of the job did they report the profit on that particular job. The other 50% reported on an annual basis, estimating the profit, and paid the proportional amount one year and the second year.

I think historically the construction industry, years ago, when the income tax was of a rather minor nature -- practically 100% reported on a completed contract basis.

Under the present regulations the completed contract basis is not according to law. It is put up with as an administrative convenience in the Department. But if the contractor changes back to the annual basis then he can't revert to the completed contract method. What they are trying to do is to bring

us into the annual basis.

THE CHAIRMAN: Where do you find this? Is it in the administrators' guide?

MR. GRAY: It is the men in the field; it is an administrative guide. We think it should be part of the Income Tax Act and give us this privilege to report on this basis.

The difficulty with the annual basis is that you may anticipate making a profit of, say, $50,000 on a million dollar contract -- just to use figures -- and at the end of the first year you may pay tax on that basis. You may find out that you are only going to get $20,000, so you have overpaid your tax; and it can work the other way, except that the only difference is that you have topay a penalty on it; and in some cases it amounts to a fair chunk of money.

MR. COYNE: Is the procedure that you have described, that is insisted upon by the Department -- can you say whether it is in accordance with the law?

MR. GRAY: No. The Wilson and Wilson case determined that. That was about three years ago; and then one year ago there was the Colford case where the Supreme Court found that a holdback does not constitute income until the holdback was certified by your architect or engineer.

Now, in a great number of instances the Colford case will protect us so far as the current year is concerned because the holdback usually amounts to more than you ever make on the contract. The percentage of profit of the average general contractor

isn't very high...

THE CHAIRMAN: The Colford case does not meet the point you are seeking?

MR. GRAY: No, it does not.

MR. CHUTTER: The Exchequer Court and in Wilson and Wilson -- the decisions both stated that the completed contract method had no status in law; but it has been Departmental practice for many many years.

THE CHAIRMAN: The point was to determine when completion occurred, and I think it has been open to some contractors to defer completion by their own maneuverings so as to hold things over.

The law has got to be positive.

MR. GRAY: The law may be positive, but your administrative procedures are not. They say that a contract that is substantially complete must be brought into the revenue. That is where the argument comes in.

THE CHAIRMAN: What did they do to change that?

MR. CHUTTER: Now it has been changed through the Colford case where it says that the actual architect's certificate shall constitute the date on which the contract is complete.

MR. MOLLER: That is correct. It is one of these cases where a decision brought about a rather surprising effect.

MR. SOMERVILLE: It means that we are anxious to get substantial completion so that we get the

money; but we wouldn't be anxious to defer...

THE CHAIRMAN: So you think the Colford case takes care of that?

MR. GRAY: Not quite.

MR. SOMERVILLE: If they make legal the completed contract method -- if they did make it legal it would, yes.

THE CHAIRMAN: The Colford case is law.

MR. SOMERVILLE: Yes; but the completed contract method isn't law, and we feel that the regulations could be maneuvered so that the Colford case would be maneuvered out of usefulness.

MR. CHUTTER: From a practical standpoint if contractors get into arguments the normal right to take an appeal is not there, and the tax officials have no legal rights because there is no basis for the completed contract method; and this puts it on a pretty inequitable basis.

MR. COYNE: I may be a little naive, but as I understand the Income Tax Act all businesses have to pay income tax on the profit from the business for a year, and that is all the Act says, except that there are certain constructions in the Act as to what may be deducted in the determination of profit. Why is it that alone among businesses the contracting business needs some other provision in the Act?

MR. STEIN: It is because of the general nature of the construction business. A manufacturing business can, at the end of the year,

report that they have manufactured so much and they have this much inventory and they have that much surplus stock, and it becomes a clean cut off.

MR. COYNE: This isn't what the Tax Act says. All the Tax Act specifies is that one must know one's profit. You are telling me that the profit from a manufacturing operation is easier to determine?

MR. STEIN: Yes; I am leadhg up to the fact that it is a rare occasion that a project is completed at the end of a a contractor's fiscal year; and they will extend -- they can come in the third quarter, or in the second quarter, or go on for a full year or half a year beyond that.

COMMISSIONER GRANT: But if they are started and completed in the fiscal year...

MR. STEIN: If it is started and completed in the fiscal year it is a simple operation; but where a contract is partially completed and it continues into the fiscal year you have merely an indication and an approximation of the true value of the work completed.

MR. COYNE: It has sometimes been suggested that section 4 of the Income Tax Act would be improved and made more certain if it made reference to the profit from a business being determined in accordance with generally accepted accounting principles. Let me put this to you: Are the accounting principles able to determine the profit of a contracting business in the year?

MR. GRAY: Each year?

MR. STEIN: To an extent they could, with a provision which supported our recommendations in favour of recognizing on a legal basis the value of the completed contract method. There seems to be among a great many people a little misinterpretation of the ruling in the Colford case. I don't think the ruling specifically said -- but I may be picked up on this -- that a holdback is not an account receivable until you have an architect's certificate.

I think there is a Superior Court ruling that a hold-back is not receivable until there is an indisputable right to the hold-back, which then by interpretation becomes dependent upon an architect's or an engineer's certification that the work is completed and that the hold-back should be released.

MR. COYNE: Is that not, in effect, an acceptance of the completed contract concept then?

MR. STEIN: No, because in all integrity a contractor can declare his completed contract and actually forward an incomplete contract. If he has been operating on the completed contract method -- which has been tolerated -- and there is a difference of opinion between the contractor and the Minister of National Revenue, he can be hauled up on the carpet two or three years later and re-assessed, and he has not a leg to stand on legally because the complete contract method is not recognized in law.

THE CHAIRMAN: Mr. Coyne, I would support, generally speaking, the fact that there is no industry where it is more difficult to determine annual profits than this industry, for the reason that many contracts run for longer period of time. Most of them run over the end of the year and one has to be concerned with taking up some of the profit of the contract or deferring the entire profit. There are rough spots in the cases I have seen, and there must be give and take in the determination of when a contract is completed. I think an accountant

would say for accounting purposes that if the contract is substantially completed it should be taken over, and that if he is holding only $1,000 or so the job is finished. I think the word "substantially" does cause some difficulties. On the other hand, it is quite unfair for the revenue to be able to keep the job open just because there are one or two dollars still to come in. So, as I say, there are some rough spots. I do not think this is an overwhelmingly difficult problem, except the writing out of a definition of the completed contract method. I think that is a difficult thing to do, and I do not know whether anyone has ever tried to set out on paper such a definition so as to give equal rights to both sides. I have not tried to write it out, but it would be difficult to do. Have you ever tried to define that?

MR. GRAY: Certainly there is no definition of the words "substantially complete".

MR. MOLLER: Well, I will try to do that, if I may.

MR. GRAY: The other thing is the question of extras. They can run on for months after a contract is complete. We had one contract, which was not a large one generally speaking, which was around $1 million, and the amount of profit we had all centred around extras. If we got extras we made a profit. If we did not we broke even. The extras actually did not accrue until April or May

the following year, and the income tax department wanted us to throw them back to the previous year.

THE CHAIRMAN: When would your job have been completed? Did the job not stand by itself, or was the whole thing held up until the extras were received?

MR. GRAY: The point was that we did not know what the extras were going to be, Some of them were split 50-50. Some were given to us in full, and others were thrown out. We do not know which ones are going to be thrown out or brought in.

THE CHAIRMAN: You cannot measure your income.

MR. GRAY: No. They threw it back to the previous year although we got them in April and May.

MR. MOLLER: Might I ask whether it is fair to compare this situation with the situation in the Exchequer Court, where Justice Thorson declared that the accrual method was not legal under the Income Tax Act? This is about the same thing. I do not think I am hurting anyone when I say that the vast majority of corporate taxpayers report their income on the accrual method, but the Exchequer Court declared that that was not permissible. There is nothing in the law which permits the accrual method to be accepted by the department.

THE CHAIRMAN: This was years ago and the law was changed.

MR. MOLLER: Yes. What I am leading up

to is the fact that the law should be changed so as to authorize the legal acceptance of the completed contract reporting method, so as to take this rather difficult situation out of the realm of contention between the department and the taxpayer. The department is able to go over every contractor's head and to tell them if they are not satisfied to go to the court.

THE CHAIRMAN: You would have everybody on your tail if you could get a clear and effective definition of this.

COMMISSIONER GRANT: Mr. Coyne, I was wondering whether or not the test applied under the Mechanics Lien Act could be made applicable to the Income Tax Act. There is a large body of jurisprudence under the Mechanics Lien Act, the effect of which is that a mechanic's lien will not apply after a given period of time from the date that the last work was done and the materials were supplied. The length of time would vary from one province to another. There is a large body of jurisprudence on this, and you cannot hold up the thing just because a plumber has not put a washer on a tap. It has to be well settled as to when a mechanic's lien expires.

MR. GRAY: The time expires 37 days after where an architect or an engineer is involved. In Ontario it expires 37 days after the architect or engineer has given his final certificate, but we are finding it extremely difficult to get final certificates.

COMMISSIONER GRANT: It goes not necessarily depend on the architect. I do not think the act mentions the architect. It simply says unless the work is done and the material is supplied.

MR. GRAY: That comes into the other phase of it, where the person who puts on the lien has to prove that under the Mechanics Lien Act he has in fact filed his lien within 37 days after he put into the place his last bit of material.

COMMISSIONER GRANT: Either he, or anybody else.

MR. GRAY: Well, anyone who files a lien.

MR. MOLLER: The question in this case is that you may not have completed your contract at all. But if you have not done any work within the 37 days you are out of luck.

COMMISSIONER GRANT: You mean, if you had not supplied any more labour?

MR. MOLLER: You are out of luck with the lien regardless whether the contract is completed or not.

MR. SOMERVILLE: I think one point worth noting here is that no government or provincial work is lienable. Therefore any rule which should be applied should be applied across the board.

MR. COYNE: In the next section you deal with the problem of income fluctuations, and you are recommending an averaging system which would be available to contractors, similar to the system now in effect for farmers. Then in paragraph 87, on page 32,

you suggest as an alternative method of stabilizing contractors' incomes an extension of the carryback of losses provision from one year to four years, the same period as is permitted in the carryforward provision. My question would be whether, in recommending this extension of the carryback of losses, you are suggesting that this should be a provision which is available to the contracting industry as such, or should it be of general application to all industry?

MR. GRAY: We have typically in mind the contracting industry, because of the peculiarity that a contractor can make a fairly reasonable sum of money, say $40,000 for three years, and then all of a sudden he gets a big contract and makes $150,000, and then in the next year earn nothing, or not make enough to make a profit. So he is going up and down. The hills and valleys of the contracting industry are well known, of course. We thought that it would be easier for his financial ability to carry on to try and even out his profits.

MR. COYNE: You are only directing your attention to your own profit?

MR. GRAY: Yes.

MR. COYNE: As a matter of interest, before you came in this morning the Shipowners were before the Commission and they posed precisely the same point. These very large fluctuations and the advantage of being able to spread the losses back was a point of some concern to them. I think I am

17

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correct in that, Mr. Chairman.

THE CHAIRMAN: Yes, Mr. Coyne.

COMMISSIONER GRANT: Before you leave that point, this may not be contemplated at all in the trade, but it does occur to me that if you were permitted to go back four years and had a record of good profits in those years, might that not be the tendency for a contractor who, say, has been unsuccessful in some of his bids, and he is carrying his overhead and has no work, to say: "I think I will underbid. I will put in a very low bid on this, because if I get it I will cover my overhead. I do not expect to make a profit. In fact, I do not care if I make a profit; I can stand a loss because I can carry it back into the good years". If that situation did develop, it would not do your industry much good, I suggest.

THE CHAIRMAN: You could recover up to 50%.

MR. SOMERVILLE: That possibility is there, but as I always feel people are more interested in making profits than losses.

COMMISSIONER GRANT: They are also interested in cutting their losses, Mr. Somerville.

MR. SOMERVILLE: Yes, that is so.

MR. STEIN: May I suggest that the construction industry is hazardous enough without deliberately underbidding on a job.

COMMISSIONER GRANT: Do you not find

today in the construction industry that there are some times when a construction firm will narrow its profits in order to get a job so as to meet its over-head?

MR. STEIN: Yes.

COMMISSIONER GRANT: This carryback to four years is only making the situation a little less hazardous.

MR. CHUTTER: But the average contractor has, of course, more than one job in a given year. He might do that on one or two jobs, but he would have many others.

COMMISSIONER GRANT: Well, some of my friends are contractors and they have had some small pickings at times, having been glad to do that so as to keep their organization together.

THE CHAIRMAN: I would have thought that these gentlemen would have replied, and I am rather surprised that they have not replied, that if the tax was at the 50% rate the fact that he would lose half himself is sufficient return. If he was taxable at the 21% rate he would not lose so much.

MR. MOLLER: Unless you are running into a loss your averaging will only help you in these marginal cases, because otherwise, unless you have a loss, the rate is at least 50%. If you incur a loss through your bid ---

COMMISSIONER GRANT: Well, I do not think you would want to make a deliberate loss, but you

might be inclined to bid on a job with less thought of profit.

MR. MOLLER: That you can do even without the averaging, and it does not help you. Unless you run into a loss the averaging will not give you any advantage.

THE CHAIRMAN: Mr. Grant is putting to you what I should have thought was a valid question, namely, would this provision cause you to bid less carefully or more recklessly than you are bidding now?

MR. SOMERVILLE: Generally speaking I think the answer is no. I think you might possibly find the odd person who might be thinking in this way, but generally speaking I do not think that that is the way in which people operate.

MR. COYNE: Those were the major points, Mr. Chairman, I was proposing to dwell on in the income tax section. I just have one question under estate taxes, otherwise I would have no further questions on the income tax section of the brief, which takes us up to page 41, I think.

MR. SOMERVILLE: Might I just make an interjection here, Mr. Chairman?

THE CHAIRMAN: Yes,please do.

MR. SOMERVILLE: Mr. Graham, would you cite the instance we were talking about last night concerning reclaiming of overpayments?

MR. GRAHAM: Yes. This was having to do with the matter of refund procedures pertaining

to refunds of corporation income tax, where we would maintain that the procedure of the department takes far too long at some considerable cost to the taxpayer. We should like to suggest that when a taxpayer makes a claim for a refund of tax which he has already paid, he accepts the onus and the authenticity of and for his claim, and that he should be entitled to his refund immediately, either through the process of having made an immediate investigation of the claim, or, if that is not possible on the part of the department, that the refund be made subject to an investigation later on, with all the penalties which would follow in the event of an erroneous claim.

THE CHAIRMAN: I think you have a point, because I read this last evening.

I recall that the last time I was in Toronto the Tax Department called me up to say they were sorry that they had not dealt with my letter of last August. I said, "I do not recall writing a letter last August". They said, "Yes; you complained about the interest we charged you". I said, "Yes, I remember. I do not think you are entitled to charge me any interest whatsoever". Then they said, "We are very sorry but we have not got around to doing it yet".

MR. GRAHAM: I can cite a case on this, Mr. Chairman. This concerns a refund that we became entitled to running to something over $100,000. We made representations to the government with adjustment of income tax return forms in early June of 1961, and at that time we applied -- by registered letter incidentally -- for a refund of the taxes applicable, which, as I say, ran to over $100,000. The refund was actually made, after many representations on our part, on November 28, 1962, a matter of about eighteen months later.

THE CHAIRMAN: You got some interest, did you not?

MR. GRAHAM: We got interest, but the difference in the interest rate that applied and the rate the department paid to us ran to something in the order of $11,000 costs to our company. We were entitled to this originally. The claim we made was paid.

MR. COYNE: Did this refund arise as a

result of your filing an amended return for the preceding year?

MR. GRAHAM: Not exactly. It is rather difficult to explain in a few words; but it arose because of a change in the classification of the company. We had been making instalment payments monthly on the basis of a Canadian fully-owned company. This company became non-resident-owned and subject to a 15% rate of taxation. We claimed for a refund of the taxes. The status of the company was made retroactive to the beginning of the fiscal year. We claimed a refund of the taxes applicable, and did not receive that for eighteen months.

MR. MOLLER: Is it possible to perhaps put this in the form of a general principle statement? It is the same as the taxpayer is responsible for underestimating or undersstating his tax. He then pays the penalty of interest which he cannot even deduct from his income. He would be safeguarded if he could make an amended return in the same way. It wipes out what the taxpayer has done before and would give him the money back. If he can audit it immediately, that is fine; if he cannot, that is the taxpayer's bad luck, and if after two years it is shown that the amended return was wrong, they could proceed accordingly and impose a tax penalty.

MR. SOMERVILLE: That was all I wanted to mention, Mr. Chairman.

THE CHAIRMAN: Let us go to estate taxes

then. You passed through provincial sales taxes, did you not, Mr. Coyne?

MR. COYNE: Yes.

THE CHAIRMAN: As a matter of fact, we are not very much concerned with them. We are concerned with estate taxes.

MR. COYNE: We discussed rather generally at the end of the morning --

THE CHAIRMAN: Putting them together.

MR. COYNE: -- the question of putting them together, yes, which is one of the recommendations made in this field. We are now at page 58, the section dealing with "Other Taxes".

MR. MOLLER: Is it permissible, Mr. Chairman, to come back and ask whether our presentation on the provision for bad debts is so clear that it does not require any further explanation?

THE CHAIRMAN: I think what you have said is perfectly clear. You just think it is too loose as matters now stand. You want a formula of some kind?

MR. MOLLER: Let me put it this way. If a formula is applied by the department owing to internal regulations, it should be made public, perhaps without legal binding force, but at least as a consistent guide to the taxpayer, instead of every audit being treated differently, with the ensuing penalty of interest payments on underpaid taxes because of having followed exactly the instructions

of the auditor before in determining the bad debt reserve. Then you are suddenly faced with another computation by the next auditor and you have to provide tax.

THE CHAIRMAN: I must say that I have had experience of this. My experience has not been of the kind that I would prefer a formula to the existing practice, because I cannot think of much difficulty that has arisen in recent years. But is it the statement of your industry that there is a lot of difficulty here? I know there has been some, but I would not have thought there had been a great deal.

MR. MOLLER: Yes, we experience a great deal of difficulty by being treated three times in succession, every time differently.

THE CHAIRMAN: Are you speaking about yourself or your industry?

MR. MOLLER: Just my company. That is my experience.

THE CHAIRMAN: Because I must say from what I have seen that there has not been a great deal of difficulty, and I would have thought that as a practice it would be better to leave it the way it is than to have a formula, because a formula would fit one industry well and you would have to have another formula for another industry. If you put one across the board, it would obviously not be very suitable.

MR. MOLLER: Perhaps I could put it this

way. There should be no penalty involved similar to the principle that if you pay your tax instalments on the basis of last year's tax you are not subject to interest penalties up to your sixth instalment if you have underpaid because your profits in the current year are higher than those in the previous year.

Applying this principle, if what you have provided is on the same basis as you provided in the year before, there should be no penalty involved for the underpayment of tax.

THE CHAIRMAN: What do you mean by "penalty"?

MR. MOLLER: Interest.

THE CHAIRMAN: I thought you did, but I was not sure. There are other penalties in the Act too. But you are talking about interest?

MR. MOLLER: Yes.

THE CHAIRMAN: You say there should be no interest if the bad debt reserve turns out to be what it had been before, providing it is on the same basis as the previous year?

MR. MOLLER: That is right. That does not introduce, really, a binding formula on an industry or anybody else, but it merely does not penalize somebody for consistently following accepted computation practices.

MR. COYNE: I suppose if in the past year you had actually been assessed, this difficulty would not arise, would it?

MR. MOLLER: That is right.

MR. COYNE: It is only where you are following a consistent procedure in respect of succeeding years that have not yet been assessed, where the effect of the different allowance can be carried back, that there are these disadvantages that you speak of?

MR. MOLLER: Yes; and usually these interest penalties go at least two years back.

MR. COYNE: I took this to be a criticism of the looseness, and perhaps inconsistency, of the administration of this provision; but I did not read any specific recommendation being voiced by the Association in paragraph 109.

MR. MOLLER: I presumed, as I was responsible for the paragraph, if I may say, that the meaning was as I have now explained.

MR. COYNE: Then, Mr. Chairman, in this latter section of the brief there is just a very small point that I wanted to explore briefly.

In dealing with estate taxes and succession duties you point out certain difficulties which these taxes introduce, particularly for small, closely-held businesses; the fact that the problem of paying estate taxes frequently results in the sale of the business either to large companies or to foreign interests.

Then in paragraph 168 on page 59 you recommend the raising of the basic exemptions on estates to a level of $100,000 and say this would permit

the continuation of small family businesses and partnerships which are now hampered in their growth by the necessity of providing for estate taxes.

My point is this. The implication that I read into this recommendation is that if the level of exemption was raised, as you recommend, that level of exemption would then pretty well cure the problems that you have been referring to in the preceding sections?

MR. MOLLER: The right word would be "alleviated" instead of "cured".

MR. COYNE: You say:

> "-- this would permit the continuation of small family businesses and partnerships which are now hampered in their growth by the necessity of providing for estate taxes."

MR. MOLLER: "Assist", "facilitate", instead of"cure".

MR. COYNE: In other words, you are not intending to be read as meaning that this change in the exemption level would solve all the problems which you describe as being present?

MR. MOLLER: No. "Facilitate" would be a much better word, if I may say so.

MR. GRAY: That bogey is in front of all of us, I think, in our family businesses.

THE CHAIRMAN: We wonder, of course, how genuine the bogey is and we keep asking for illustrations or examples of family businesses which

have been sold because of succession duties. I suppose there are some; I do not deny that there are; but in most cases I would have thought there were a number of reasons for it, one of which may be succession duties.

Mind you, we have had legislation to try to straighten out the combined effect of succession duties and income taxes, and I would have thought we had been fairly successful in doing that. Furthermore, this has been talked about so much in the last 15 or 20 years that I would have thought that most shareholders would have found a way to get themselves out of trouble, either by insurance or re-arranging their affairs in some way.

MR. GRAY: They have, to a certain extent, but they cannot go down too far. You can make certain provisions for the senior man by trying to settle his estate at a certain amount, but then you come to the next generation and if there are three or four of them, and two die very shortly, you are in the same mess that you were in before.

One of the reasons that they go into a public company from a private company is the fact that it is on the market and the value is there. It is set out in writing. At least you do not have to get into an argument with the department as to what the estate is worth, which I think is mentioned here. One of the problems in this respect is that one valuation may be, say, two and a half times another valuation. There is a terrific difference of

opinion on the value of an estate.

THE CHAIRMAN: I thought the figures you give at the end of this submission were most helpful. I was a little surprised at the decline in construction for manufacturer, and graph No. 5 indicates what a diminishing part of total construction that is.

I presume that as it has gone down, social capital and other forms have gone up. But of course as one looks around Canada it would seem to me that most factories have pretty good-looking buildings now, and I suspect you have done a great deal of construction which is still very good. In fact, it looks to me as though you were doing all right up until about 1957 or a little after that, according to this graph.

I just wonder whether just about everybody in manufacturing now is not manufacturing in pretty good facilities. After the war, of course, we needed new facilties. Everybody built plants at that time, I think, and now I see old plants being closed and new ones being built right and left. I wonder if there is much more catching up to do. I would not have thought so. Of course, the profits of manufacturing have been fairly steady the last few years, as you know very well.

MR. CHUTTER: The fact that there is a volume of $400 million to $500 million worth of plant construction is a sizeable amount, and although there is servicing and many lines of manufacture there does not appear to be opportunity for expansion

in this respect as there is in a good many other things.

Also, with plant modernization you may have a plant the physical shape of which is quite satisfactory and will stand for 50 years, but its design, lay-out, and so forth are such that they are outmoded and cannot compete with modern structures.

These are some of the aspects which, even with a high rate of production, mean that there is a desire on the part of many aspects of the manufacturing business to extend, modernize, relocate, or do all those three things; and if there was a little more encouragement, they would perhaps do more.

COMMISSIONER PERRY: There is one point that I might mention. On pages 33 and 34, where you are dealing with the very important question of income tax rates, the arguments you advance are quite relevant and important, but it seems to me they are all advanced on behalf of your clients.

Do you encounter no difficulty yourselves with international competition in the construction field, on which income tax rates might have some bearing?

MR. CHUTTER: As far as Canada is concerned, some foreign companies may have some tax advantages. They may have other disadvantages. This was shown up on joint programs such as the

Seaway, where the more liberalized write-off conditions for construction equipment enjoyed by the American contractors, plus the fact that they could borrow at the lower rate of interest, and so on -- these and the other advantages combined to give them quite a considerable advantage in that area.

COMMISSIONER PERRY: But what would you think the position will be when their corporate rate, for example, is down to 47%, as appears destined at some time or the other? Do you think the American contractor will have a competitive advantage over you then?

MR. MOLLER: Would not the American contractor coming to do business in Canada be subject to Canadian rates on his Canadian profits?

COMMISSIONER PERRY: Yes, that is quite true; but he will have behind him a company which will be all the more wealthy because of the lower American rates, and perhaps will be able to compete.

MR. CHUTTER: There are some conspicuous examples of large foreign-based firms in Canada; but by and large the construction industry in Canada is a home industry, virtually without exception.

MR. GRAY: Except the ones in the north. There are some around Gander that I think are Americans.

MR. CHUTTER: There are examples, and

they may have a fair sized volume of business; but they still, in the aggregate are in the minority.

THE CHAIRMAN: The proportion of your business that is done abroad is pretty small, is it? I know you are doing some of the important contracts around the world, but when one adds it up and compares it with the $7.6 billion, or whatever it is, it must be very small, must it not?

Thank you very much indeed, gentlemen. This has been most helpful to us. You have given us a great deal of material to think about, and some pretty peppy arguments. We will continue to ponder these. Have you anything you would like to say to us?

MR. SOMERVILLE: I do not think so, sir.

THE CHAIRMAN: Then good day, gentlemen, and many thanks. We will stand over until 9:30.

THE SECRETARY: Mr. Chairman, before we adjourn I would like to enter one brief into the record. It is the brief of Mr. P.C. Forsyth of Ottawa, and it will be Exhibit 324.

EXHIBIT 324: Brief of Mr. P.C. Forsyth, Ottawa.

--- Adjournment.